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No. 04-

Supreme Court, U.S
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IN THE

Supreme Court of the United States

INVERSIONES ERRAZURIZ LIMITADA (f/k/a Inversiones Errazuriz S.A.); SUPERMERCADOS UNIMARC S.A. (f/k/a Comercial E Inmobiliaria Unimarc S.A.); PESQUERA NACIONAL S.A.; UNIMARC ABASTECIMIENTOS S.A.; CIDEF S.A.; SALMONES UNIMARC S.A.; INDUSTRIA FORESTAL NACIONAL S.A.; FORESTAL REGIONAL S.A.; CIDEF ARGENTINA S.A.; CORPORACION DE INVERSIONES Y DESARROLLO FINANCIERO CIDEF S.A.; and SOCIEDAD CONTRACTUAL MINERA COMPANIA DE SALITRE Y YODO PRIMERA REGION (f/k/a Compania De Salitre Y Yodo Primera Region S.A.),

Petitioners,

v.

STATE STREET BANK AND TRUST COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Pursuant to this Court's "Erie progeny" precedent in *Gasperini v. Center for Humanities, Inc.*, 518 U.S. 415 (1996), must the federal courts, in a diversity case, apply state law standards in the default judgment context where the objective of those state law standards is to prevent an award of excessive damages against a defaulting defendant?

5

The Second Circuit, in a diversity case, applied a federal law standard to sustain a damage award of about $140 million in a default judgment, under circumstances where petitioners were not allowed to contest the amount of the damages at an evidentiary hearing *and* where respondent's diversity complaint only sought unliquidated damages "in an amount to be determined at trial." However, New York's state law standard (a) prohibits a damage award in a default judgment for an amount that exceeds the amount requested in the complaint and (b) mandates that a defaulting defendant be afforded a meaningful opportunity at an evidentiary hearing to challenge a requested damage amount through, *inter alia*, cross-examination of witnesses and other proof that may mitigate the damage amount. In *Gasperini*, 518 U.S., at 430, this Court stated that "Just as the *Erie* principle precludes a federal court from giving a state-created claim 'longer life . . . than [the claim] would have had in the state court,' *Ragan*, 337 U.S., at 533-34, 69 S. Ct., at 1235, so *Erie* precludes a recovery in federal court significantly larger than the recovery that would have been tolerated in state court." Therefore, since the Second Circuit's ruling conflicts with this Court's precedent in *Gasperini* and violates the constitutional allocation of judicial power between the state and federal judicial systems, the damage amount in the default judgment is void and should be vacated, and petitioners should be afforded their rights under New York law to challenge the requested damage amount.

II. Even if this Court concludes that the federal courts, in a diversity case, are authorized to apply a federal law standard in the default judgment context, did the Second Circuit violate petitioners' federal due-process rights in this case, as set forth in Rule 54(c) and Rule 55(b)(2) of the Federal Rules of Civil Procedure ("FRCP") and the Fifth Amendment to the U.S. Constitution, by sustaining a damage award of about $140 million in a default judgment, despite the fact that respondent's diversity complaint only sought unliquidated damages "in an amount to be determined at trial" and petitioners were not allowed to contest the damage amount at an evidentiary hearing?

FRCP 54(c) is not discretionary and mandates that "A judgment by default shall not be different in kind from or exceed in amount that prayed for in the demand for judgment." FRCP 55(b)(2) is discretionary and authorizes the court to conduct an evidentiary hearing "to determine the amount of damages or to establish the truth of any averment by evidence or to make an investigation of any other matter." The Fifth Amendment to the U.S. Constitution prohibits the deprivation of property without due process of law. Thus, in *Klapprott v. United States*, 335 U.S. 601, 609 (1949), this Court stated that "The judgment is void if the hearing of evidence is a legal prerequisite to rendition of a valid default judgment . . ." Therefore, since respondent's complaint requested damages "in an amount to be determined at trial" — but petitioners were not allowed to contest the damage amount at an evidentiary hearing — the damage amount of about $140 million in the default judgment is void and should be vacated as a matter of federal law, and petitioners should be afforded their federal due process rights to challenge the requested damage amount.

III. Did the Second Circuit violate this Court's precedent in *Klapprott v. United States*, 335 U.S. 601 (1949) by ruling that even if, *arguendo*, the $140 million default judgment is void, that void judgment will nonetheless remain "valid" because an "untimely" vacatur motion under FRCP 60(b)(4) was made 15 months after the entry thereof?

In *Klapprott*, this Court vacated a void judgment four years after it had been entered. Similarly, there are federal appellate decisions, outside the Second Circuit, which hold that (a) "there is no time limit on an attack on a judgment as void," (b) "the requirement that the [vacatur] motion be made within a 'reasonable time,' which seems literally to apply to motions under Rule 60(b)(4), cannot be enforced with regard to this class of motion" and (c) "a void judgment cannot acquire validity because of laches on the part of the judgment debtor." Therefore, since the Second Circuit's ruling conflicts with this Court's precedent in *Klapprott*, and conflicts with the better-reasoned precedent from other circuits, the void default judgment for about $140 million must be vacated and cannot be allowed to remain "valid."

IV. Did the Second Circuit violate this Court's precedent in *Hazel-Atlas Glass Co. v. Hartford-Empire Co.*, 322 U.S. 238 (1944) by ruling that petitioners are not entitled to an evidentiary hearing on their motion to vacate the default judgment under FRCP 60(b) or FRCP 60(b)(3) even if, *arguendo*, respondent had intentionally concealed from the court a countersigned version of a letter-agreement wherein respondent had acknowledged that certain petitioners are *not liable as guarantors for more than $80 million*?

In *Hazel-Atlas*, this Court held that (a) charges of litigation-misconduct could not, "if in dispute, be finally determined on ex parte affidavits without examination and cross examination of witnesses" [322 U.S., at 249-50, fn. 5] and (b) a judgment debtor's lack of diligence in exposing the misconduct does not prevent the Court from vacating the judgment: "Surely it cannot be that preservation of the integrity of the judicial process must always wait upon the diligence of litigants. The public welfare demands that the agencies of public justice be not so impotent that they must always be mute, and helpless victims of deception and fraud." Moreover, several federal circuits have held that evidentiary proceedings are warranted in this context where, as here, the record suggests an "inference of fraud" or a "colorable claim" of litigation-misconduct. Therefore, since the Second Circuit's ruling conflicts with this Court's precedent in *Hazel-Atlas*, and conflicts with the better-reasoned precedent from other circuits, the motion to vacate the default judgment should be granted, to the extent of directing an evidentiary hearing to determine whether respondent concealed the countersigned version of the letter-agreement from the court in an effort to obtain a judgment in excess of $80 million to which respondent, pursuant to the countersigned letter-agreement, is not entitled.

V. Did the Second Circuit commit legal error in this diversity case by denying the motion to vacate the default judgment, even though controlling New York substantive law establishes that petitioners alleged a meritorious defense or counterclaim based upon actions taken by respondent (an unsecured creditor under New York law) that violate its implied contractual obligation of good-faith and fair-dealing to petitioners under the unsecured financing agreements?

Pursuant to the constitutionally-based *Erie* doctrine, the Second Circuit, in this diversity case, is required to apply New York substantive law as announced by the highest state court (or by the intermediate state appellate courts if the highest state court has not decided the issue). Yet, the Second Circuit rejected the merits of petitioners' argument on the basis of a single 1983 state trial court decision and one federal decision, but both of these decisions are plainly inapplicable to the factual situation in the case at bar. Indeed, the Second Circuit failed to address, much less distinguish, the controlling decisions from the New York appellate courts which establish that petitioners alleged a legally sufficient defense or counterclaim under New York law. Since this Court essentially sits as a final "state court" on substantive issues in a diversity case - - and since petitioners have been exposed to a default judgment of more than $140 million based upon the lower federal courts' misapplication of New York law - - the default judgment should be vacated and petitioners should be afforded their due-process rights to pursue discovery from respondent concerning the merits.

Alternatively, if this Court is uncertain as to whether petitioners have alleged a cognizable defense or counterclaim under New York law, then this Court should certify that state law issue to the New York State Court of Appeals for an authoritative determination. As defendants, petitioners have been compelled to litigate this state law case in federal court. Thus, petitioners should not be bound by a massive diversity default judgment where there is no authoritative state court decision rejecting the merits of their defense and counterclaim under New York law.

LIST OF PARTIES

The parties are set forth in the caption of this petition for a writ of certiorari.

CORPORATE DISCLOSURE STATEMENT

None of the petitioners is a publicly held American company. U.S. counsel for petitioners, a group of South American companies, is advised that the lead petitioner Inversiones Errazuriz Limitada (a) is a corporation organized and existing under the laws of the country of Chile and (b) is either a "corporate parent" or "affiliate" of the other petitioners.

TABLE OF CONTENTS

Page

Questions Presented i

List Of Parties vi

Corporate Disclosure Statement vi

Table Of Contents vii

Table Of Cited Authorities x

Table Of Appendices xv

Opinion Below 1

Statement Of Jurisdiction 1

Constitutional And Statutory Provisions Involved 1

Statement Of The Case 3

Reasons For Granting The Petition 15

Point I 15

Review Is Warranted In This Diversity Case Because The Second Circuit's Ruling:

(A) Incorrectly Applies A Federal Law Standard In The Default Judgment Context To Sustain A Massive Damages Award For About $140 Million, On A State-Created Claim, In Violation Of New York's State Law Standard; And

Page

(B) Conflicts With This Court's "Erie Progeny" Precedent In *Gasperini v. Center For Humanities, Inc.,* 518 U.S. 415 (1996), Which Directs That A Damages Recovery On A State-Created Claim In A Federal Court Diversity Case Cannot Exceed The Damages Recovery That Could Be Obtained On That State-Created Claim In State Court.

Point II 21

Review Is Also Warranted Because Even If, *Arguendo,* Federal Law Applies To The Default Judgment, The Second Circuit's Ruling Violates Federal Due Process Principles Under FRCP 54(c) And FRCP 55(b)(2).

Point III 23

Review Is Also Warranted Because The Second Circuit Violated *Klapprott v. United States,* 335 U.S. 601 (1949), By Ruling That Even If, *Arguendo,* The Massive Default Judgment Is Void, That Void Judgment Will Nonetheless Remain "Valid" Because An "Untimely" Vacatur Motion Under FRCP 60(b)(4) Was Made 15 Months After The Entry Thereof.

Point IV 24

Review Is Also Warranted Because The Second Circuit Violated This Court's Precedent In *Hazel-Atlas Glass Co. v. Hartford-Empire Co.,* 322 U.S. 238 (1944), By Ruling That Petitioners Are Not Entitled To An

Page

Evidentiary Hearing Even If, *Arguendo*, Respondent Intentionally Concealed From The Court A Countersigned Version Of A Letter-Agreement Wherein Respondent Indicated That Certain Petitioners Are *Not Liable* As Guarantors For More Than $80 Million.

Point V 28

Review Is Also Warranted In This Diversity Case Because The Second Circuit Ignored Controlling New York Law Establishing That Petitioners Had Alleged A Meritorious Defense Or Counterclaim Sufficient To Vacate The Liability Default. In The Alternative, Certification Of This State-Law Issue, Affecting More Than $140 Million On The Merits, For An Authoritative State Court Resolution Is Warranted.

Conclusion 30

TABLE OF CITED AUTHORITIES

Page

FEDERAL CASES

Arizonans for Official English v. Arizona, 520 U.S. 43, 117 S. Ct. 1055 (1997) 30

Britton v. Swift Transportation Company, Inc.., 127 F.3d 616 (7th Cir. 1997) 25

Browning-Ferris Industries of Vermont Inc. v. Kelco Disposal Inc., 492 U.S. 257, 109 S. Ct. 2909 (1989) 15

Cleveland Board of Education v. Loudermill, 470 U.S. 532, 105 S. Ct. 1487 (1985) 24

Compton v. Alton Steamship Company, Inc., 608 F.2d 96 (4th Cir 1979) 21

Export Group v. Industries, Inc., 54 F.3d 1466 (9th Cir. 1995) 23

Gasperini v. Center for Humanities, Inc., 518 U.S. 415, 116 S. Ct. 2211 (1996) .... i, 15, 16, 19

Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308, 119 S. Ct. 1961 (1999) 3, 28

Guaranty Trust Co. of New York v. York, 326 U.S. 99, 65 S. Ct. 1464 (1945) 20

Hanna v. Plumer, 380 U.S. 460, 85 S. Ct. 1136 (1965) 16

Harper MacLeod Solicitors v. Keaty & Keaty, 260 F.3d 389 (5th Cir. 2001) 23

Page

Hazel-Atlas Glass Co. v. Hartford-Empire Co., 322 U.S. 238, 64 S. Ct. 997 (1944) .... iii, iv, 24, 25, 27

Klapprott v. United States, 335 U.S. 601, 69 S. Ct. 384 (1949) .... ii, iii, 22, 23, 24

New York Life Insurance Co. v. Brown, 84 F.3d 137 (5th Cir. 1996) 23

Ohio Central R. Co. v. Central Trust Co., 133 U.S. 83, 10 S. Ct. 235 (1890) 21

Pearson v. First NH Mortgage Corp., 200 F.3d 30 (1st Cir. 1999) 25

Printz v. United States, 521 U.S. 898, 117 S. Ct. 2365 (1997) 18

Pueblo Trading Co. v. El Camino Irr. District, 169 F.2d 312 (9th Cir. 1948) 21

Ragan v. Merchants Transfer and Warehouse Co., 337 U.S. 530, 69 S. Ct. 1233 .... i, 15, 20

Semtek International Inc. v. Lockheed Martin Corp., 531 U.S. 497, 121 S. Ct. 1021 (2001) 20

State Street Bank and Trust Company v. Inversiones Errazuriz Limitada, et al., 230 F. Supp. 2d 313 (S.D.N.Y. 2002) 1

State Street Bank and Trust Company v. Inversiones Errazuriz Limitada, et al., 246 F. Supp. 2d 231 (S.D.N.Y. 2002) 1

Page

State Street Bank and Trust Company v. Inversiones Errazuriz Limitada, et al., 374 F.3d 158 (2d Cir. 2004) 1

Thomson v. Wooster, 114 U.S. 104, 5 S. Ct. 788 (1885) 21

Walker v. Armco Steel Corp., 446 U.S. 740, 100 S. Ct. 1978, 64 L. Ed. 2d 659 (1980) 16

STATE CASES

511 West 232nd Owners Corp. v. Jennifer Realty Co., 98 N.Y.2d 144 (2002) 29

Amusement Business Underwriters v. American International Group, Inc., 66 N.Y.2d 878 (1985) . . 17

Ashland Mgmt. Inc. v. Janien, 82 N.Y.2d 395 (1993) 29

Credit Agricole Indosuez v. Rossiyskiy Kredit Bank, 94 N.Y.2d 541 (2000) 3, 28

F&S Pharmacy, Inc. v. Dandra Realty Corp., 754 N.Y.S.2d 256 (N.Y. App. Div. 1st Dept. 2003) 29

McClelland v. Climax Hosiery Mills, 252 N.Y. 347 (1930) 17

Reynolds Securities, Inc. v. Underwriters Bank and Trust Company, 44 N.Y.2d 568 (1978) 17

Page

S&S Hotel Venture Limited Partnership v. 777 S.H. Corp., 108 A.D.2d 351 (N.Y. App. Div. 1st Dept. 1985) 29

Slote v. Cascade Holding Corp., 276 N.Y. 239 (1937) ... 16

UNITED STATES CONSTITUTION

Fifth Amendment .... ii, 1, 16, 18, 21, 23, 30

FEDERAL STATUTES

FRCP 54(c) .... ii, 2, 14, 21, 22

FRCP 55 6

FRCP 55(b)(2) .... ii, 2, 14, 21, 22

FRCP 60(b) .... iii, 2, 7, 11, 13, 25, 27

FRCP 60(b)(1) 7

FRCP 60(b)(3) .... iii, 11, 13, 27

FRCP 60(b)(4) .... iii, 12, 14, 23, 24

28 U.S.C. § 1254(1) 1

28 U.S.C. § 1652 .... 1, 18

28 U.S.C. § 1655 3

28 U.S.C. § 2072(b) 1, 24

Page

STATE STATUTES

CPLR 3215(b) 16

OTHER AUTHORITIES

Restatement (2d) of Contracts 29

TABLE OF APPENDICES

Page

Appendix A — Opinion Of The United States Court Of Appeals For The Second Circuit Decided June 15, 2004 .... 1a

Appendix B — Opinion Of The United States District Court For The Southern District Of New York Dated April 17, 2003 .... 41a

Appendix C — Opinion Of The United States District Court For The Southern District Of New York Dated November 5, 2002 .... 48a

Appendix D — Report And Recommendation To The Honorable Robert L. Carter Of The United States District Court For The Southern District Of New York Dated August 15, 2002 .... 71a

Appendix E — Order Of The United States District Court For The Southern District Of New York Dated March 6, 2002 .... 116a

Appendix F — Opinion Of The United States District Court For The Southern District Of New York Dated February 4, 2002 .... 119a

Appendix G — Order Of The United State Court Of Appeals For The Second Circuit Denying Petition For Rehearing Filed September 1, 2004 .... 141a

Appendix H — Relevant Statutes 143a

Appendix I — Letter From Francisco Javier Errázuriz O., General Manager, Inversiones Errázuriz Limitada To Dan Lobdell, Vice President, International Corporate Banking Dated January 8, 1999 .... 146a

OPINION BELOW

The opinion of the United States Court of Appeals for the Second Circuit is reported at *State Street Bank and Trust Company v. Inversiones Errazuriz Limitada, et al.*, 374 F.3d 158 (2d Cir. 2004). The Second Circuit's order denying the petition for rehearing or rehearing en banc is unreported. The Second Circuit's opinion affirmed the decisions of the United States District Court for the Southern District of New York. Some of the District Court decisions are reported: (a) *State Street Bank and Trust Company v. Inversiones Errazuriz Limitada, et al.*, 230 F. Supp. 2d 313 (S.D.N.Y. 2002); and (b) *State Street Bank and Trust Company v. Inversiones Errazuriz Limitada, et al.*, 246 F. Supp. 2d 231 (S.D.N.Y. 2002). Some of the District Court decisions are not reported. All of these foregoing determinations are set forth in Appendices A-F.

STATEMENT OF JURISDICTION

This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1). The Second Circuit's opinion was rendered on June 15, 2004. The Second Circuit's order denying the petition for rehearing or rehearing en banc was rendered on September 1, 2004. *See* Appendices A and G.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Due Process Clause Of The Fifth Amendment To The Constitution.

> No person shall be . . . deprived of life, liberty or property, without due process of law . . .

Title 28 United States Code, Section 1652.

State laws as rules of decision.

> The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.

Title 28 United States Code, Section 2072(b).

Rules of procedure and evidence; power to prescribe.

> Such rules [of federal civil procedure] shall not abridge, enlarge or modify any substantive right.

Rule 54(c) of the Federal Rules of Civil Procedure.
Demand for Judgment.

A judgment by default shall not be different in kind from or exceed in amount that prayed for in the demand for judgment. Except as to a party against whom a judgment is entered by default, every final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in the party's pleadings.

Rule 55(b)(2) of the Federal Rules of Civil Procedure.

Judgment by default may be entered as follows:

(2) By the Court. In all other cases the party entitled to a judgment by default shall apply to the court therefor; but no judgment by default shall be entered against an infant or incompetent person unless represented in the action by a general guardian, committee, conservator, or other such representative who has appeared therein. If the party against whom judgment by default is sought has appeared in the action, the party (or, if appearing by representative, the party's representative) shall be served with written notice of the application for judgment at least 3 days prior to the hearing on such application. If, in order to enable the court to enter judgment or to carry it into effect, it is necessary to take an account or to determine the amount of damages or to establish the truth of any averment by evidence or to make an investigation of any other matter, the court may conduct such hearings or order such references as it deems necessary and proper and shall accord a right of trial by jury to the parties when and as required by any statute of the United States.

Rule 60(b) of the Federal Rules of Civil Procedure.
Relief From Judgment or Order.

(b) Mistakes; Inadvertence; Excusable Neglect; Newly Discovered Evidence; Fraud, Etc.

On motion and upon such terms as are just, the court may relieve a party or a party's legal representative from a final judgment, order, or proceeding for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence which by due diligence could not have been discovered in time to move for a new trial under Rule 59(b); (3) fraud (whether heretofore denominated intrinsic or extrinsic), misrepresentation, or other misconduct of an adverse party; (4) the judgment is void; (5) the judgment has been satisfied, released, or discharged, or a prior judgment upon which it is based has been reversed or otherwise vacated, or it is no longer equitable that the judgment should have prospective application; or (6) any other reason justifying relief from the operation of the judgment. The motion shall be made within a reasonable time, and for reasons (1), (2) and (3) not more than one year after the judgment, order, or proceeding was entered or taken. A motion under this subdivision (b) does not affect the finality of a judgment or suspend its operation. This rule does not limit the power of a court to entertain an independent action to relieve a party from a judgment, order, or proceeding, or to grant relief to a defendant not actually personally notified as provided in Title 28, U.S.C., §1655, or to set aside a judgment for fraud upon the court. Writs of coram nobis, coram vobis, audita querela, and bills of review and bills in the nature of a bill of review, are abolished, and the procedure for obtaining any relief from a judgment shall be by motion as prescribed in these rules or by an independent action.

STATEMENT OF THE CASE

In the mid 1990's, respondent [as unsecured creditor] and petitioners [as debtors or guarantors] entered into unsecured financing agreements providing, *inter alia*, that: (a) New York law shall govern their commercial relations and disputes; and (b) a proposed asset-sale would generally need respondent's "consent." Prior to the entry of a judgment on the merits, New York law prohibits an unsecured creditor from interfering with the use of unencumbered property belonging to its debtor or guarantor.[1]

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[1] *See Credit Agricole Indosuez v. Rossiyskiy Kredit Bank*, 94 N.Y.2d 541, 549 (N.Y. 2000) (New York law); *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 319-20, 119 S. Ct. 1961 (1999) (same proposition under federal equity law).

In late 2000, subsequent to petitioners' default under the unsecured financing agreements, but prior to respondent's commencement of this diversity case on April 16, 2001, Francisco Javier Errazuriz Talavera (the "Senator"), a Senator in the Chilean National Legislature and former presidential candidate, traveled to the United States for workout discussions with respondent's representatives concerning a mutually acceptable way for payment of the unsecured debt. The Senator and his family are the principal owners of petitioners' stock. At the workout discussions, respondent advised the Senator that the unsecured debt would not be refinanced and that petitioners would have to sell their assets in order to pay the same.

Petitioners then entered into asset-sale negotiations with Sociedad Quimica y Minera de Chile ("SQM"), their primary Chilean competitor in the nitrate and iodine business. Following extensive due-diligence over many months, SQM ultimately agreed to pay $140 million for petitioners' nitrate, iodine and mining assets, so long as respondent gave its "consent" to the transaction. Understandably, SQM did not wish to run the risk of "buying a lawsuit" from respondent if SQM were to consummate the asset-sale without respondent's "consent."

On April 16, 2001, respondent commenced this diversity case. Nonetheless, from April 2001 until August 2001, extensive negotiations ensued between respondent and petitioners as to the conditions under which respondent, an unsecured creditor, would provide its "consent" to the pending $140 million asset-sale. As the District Court correctly noted:

> The parties' effort to work out the loans continued even after this suit was filed in April 2001. Indeed, it appears that the parties were operating under an informal standstill agreement, pursuant to which [respondent] agreed not to pursue its remedies under the [unsecured] Credit Agreements and Guaranties in this lawsuit without giving [petitioners] at least one week's advance notice.

In August 2001: (a) SQM provided proof of its ability to finance the $140 million purchase price; and (b) respondent agreed to accept $87 million from the sale-proceeds. This $87 million sum represented the entire amount of the unencumbered proceeds that would remain after an "off-the-top" payment of $53 million to satisfy liens against the assets held by secured creditors. Petitioners (and SQM) expected that respondent, an unsecured creditor, would immediately provide its "consent" to the asset-sale because respondent would be receiving all of the unencumbered proceeds from the asset-sale and respondent did not have a lien in, or security interest against, the assets.

Unfortunately, the $140 million asset-sale never closed because respondent, in violation of its obligation of good-faith and fair-dealing under New York law, withheld its "consent" to the sale in retaliation for petitioners' refusal to renegotiate the terms of the unsecured agreements. Although respondent, as an unsecured creditor, had no right under the unsecured agreements (or New York law) to extract collateral from petitioners as a "condition" to providing its "consent" to the asset-sale - - and despite the fact that respondent would be receiving all of the unencumbered proceeds from the asset-sale - - respondent demanded that petitioner arrange for a security interest to be granted in other unencumbered property as a "quid pro quo" for a "consent" to the asset-sale. Moreover, the other unencumbered property was held in the name of a separate company which owes no money to respondent and is not even a party to this diversity lawsuit.

By imposing a legally unauthorized condition, under New York law, as a "quid pro quo" for a "consent" to the asset-sale, respondent has caused damages to petitioners through the loss of $140 million that would have been realized by petitioners in August 2001 - - with $53 million paid by petitioners to secured creditors and the entire $87 million unencumbered balance paid by petitioners to the unsecured respondent. The Senator expressed his frustration with this situation before the District Court:

> So why couldn't we sell to be able to pay? I have never understood what happened. I was a banker during more than ten years, on the board of a bank. When somebody tried to pay, I was very happy. But when I tried to pay, I

> couldn't pay. I couldn't sell, even what belongs to myself and my family.

When respondent realized that petitioners would not accede to respondent's legally unauthorized condition demanding a renegotiation of the unsecured agreements, respondent terminated further discussions about its refusal to "consent" to the $140 million asset-sale. Instead, in late September 2001, respondent filed a motion under FRCP 55 seeking a default judgment against petitioners.

Petitioners understandably expected that their longstanding American counsel, who had represented their interests during the asset-sale discussions, would oppose the default judgment motion and litigate petitioners' defenses and counterclaims in response to the complaint. As the District Court correctly noted:

> There is no indication that the [petitioners] instead opted to sit on their haunches. Quite to the contrary, as [attorney] Franklin explained, when he and the Senator discussed whether it might be preferable for the [petitioners] not to appear, '[t]he Senator didn't agree with that and his Chilean counsel didn't agree with that'.

Indeed, on October 10, 2001, petitioners wired $200,000 to their former counsel for purposes of opposing the default judgment motion and litigating their defenses and counterclaims to the complaint. Unfortunately, the day after it received that $200,000 wire, former counsel advised petitioners that such firm would not represent petitioners' interests in response to the default judgment motion, even though that default judgment motion was returnable the following day.

As a good-faith gesture during the prior asset-sale discussions, petitioners had appeared in this diversity case by executing a stipulation acknowledging the personal jurisdiction of the court. Although petitioners' former counsel had arranged for that stipulation to be executed by petitioners, that law firm had never filed any court papers listing itself as counsel of record for petitioners in this case. Due to former counsel's eleventh hour abandonment of petitioner, respondent's default judgment motion was submitted as "unopposed" to the District Court on the October 12, 2001 return date.

In its complaint, respondent sought a judgment for unliquidated damages "in an amount to be determined at trial." However, contrary to its complaint, respondent's subsequent default judgment motion papers contain a proposed "Order Approving Form And Directing Entry Of Default Judgment" in which respondent claims that a massive amount of damages (about $140 million) should now be "liquidated" and awarded against petitioners. Since petitioners had been abandoned at the eleventh hour by their former counsel, they were unable to file any timely opposition to respondent's default judgment motion papers. Due to petitioners' "default," the District Court granted the default judgment motion and signed respondent's proposed default judgment order, in which damages are liquidated in the massive amount of about $140 million. On December 4, 2001, the Clerk of the District Court entered a final Default Judgment, based upon that order, imposing not only liability on petitioners, but also directing petitioners to pay damages in the massive liquidated sum of about $140 million.

On or about December 19, 2001, petitioners, through newly retained American counsel, filed a multifaceted motion under FRCP 60(b) seeking to vacate the Default Judgment. By order, dated February 4, 2002, the District Court denied certain branches of that vacatur motion, and referred certain issues pertaining to the "excusable neglect" branch under FRCP 60(b)(1) to a Magistrate Judge "for further inquiry." Appendix F.

On March 6, 2002, the Magistrate Judge presided over a transcribed court conference regarding the precise scope of the "further inquiry" on the referred issues. Petitioners' counsel explained that: (a) the documents which petitioners had found in their files, relating to their defenses and counterclaims, had already been filed as exhibits on their vacatur motion; (b) petitioners maintain that such documentary evidence, together with their extensive affidavits, had already established a meritorious defense or counterclaim; and (c) in view of the ill-defined reference for a "further inquiry", petitioners requested discovery, out of an abundance of caution, to obtain additional documents and evidence in support of the merits of their defenses and counterclaims.

The Magistrate Judge indicated that, in order for petitioners to prevail on the meritorious defense element: (a) merits-related discovery from respondent and non-parties [such as SQM] would be unnecessary and time-consuming because petitioners need only show that they have a "legally sufficient counterclaim" or a "colorable defense" and, therefore; (b) the merits-related element, unlike the other "excusable neglect" elements as to the "willfulness" of the default and the "prejudice" to respondent, could be addressed by the prior "affidavits."

The Magistrate Judge issued a limited discovery order [Appendix E] which: (a) authorized petitioners to take depositions of their former counsel relating to whether their default was "willful;" (b) directed petitioners to provide answers to interrogatories from respondent "to elicit further details" regarding petitioners' reliance upon their former counsel to represent their interests in this action; (c) directed respondent to provide answers to interrogatories from petitioners "to elicit further details regarding the specific prejudice that plaintiff alleges it will suffer if the default judgment is vacated;" and (d) authorized the filing of affidavits, exhibits, and memoranda. Significantly, unlike the other "excusable neglect" elements as to the "willfulness" of the default and the "prejudice" to respondent for which certain limited discovery was authorized, *the Court did not allow petitioner to obtain any merits-related discovery from respondent or any third-parties. See* Appendix E.

Pursuant to the limited discovery authorized by the Court, respondent submitted supplemental answers to the "prejudice" interrogatories which admitted, in substance, that the purpose for the "consent" clause in the unsecured agreements was to ensure that petitioners' assets would be used, if necessary, to pay the unsecured debt. Yet, since petitioners' $140 million asset-sale required that the unsecured respondent receive the entire amount of the unencumbered proceeds of $87 million, that asset-sale did ensure that the entire unsecured portion of petitioners' assets would be used to pay the unsecured debt. Respondent's interrogatory answers failed to explain how respondent was authorized under New York law to use the "consent" clause in the unsecured agreements to extract a security interest from petitioners against other, unencumbered property even though the unsecured respondent would have received the entire $87 million amount of the unsecured proceeds arising from the asset-sale.

On May 23-24, 2002, the Magistrate Judge presided over a transcribed court hearing regarding the referred issues. The Senator and two other principals of petitioners traveled from Chile to provide first-hand testimony to the Court regarding the referred issues. A leading Chilean legal expert, who had formerly been a Chilean state prosecutor for over 14 years, also testified, *inter alia*, that Chilean law requires that a claim for unlawful interference in an asset-sale must be determined at a trial. The only witnesses produced by respondent were two partners from the law firm that had previously represented petitioners, but restricted to the issue of the "willfulness" of the default.

In a Report and Recommendation dated August 15, 2002, the Magistrate Judge found that petitioners had understandably relied on their former counsel to represent them in this case, and that petitioners had not engaged in a "willful" default intended to "delay" respondent's attempted litigation of its claims. However, the Magistrate Judge found that: (a) petitioners' allegations did not establish a potentially meritorious defense or related counterclaim under New York law; and (b) respondent would suffer an "impermissible level of prejudice" if the Default Judgment were vacated, although the Court did not identify any specific amount of economic "harm" that would be sustained by respondent if the merits of this case were litigated. *See* Appendix D. Petitioners filed objections with the District Court concerning the Magistrate Judge's adverse determinations on the "excusable neglect" issues of a "meritorious defense or related counterclaim" and an "impermissible level of prejudice." Petitioners also applied for a discovery remand on the issue of a "meritorious defense or related counterclaim" if the District Court determined that the evidence adduced by petitioners, without the benefit of discovery, was otherwise "insufficient" to satisfy this element. Respondent did not file objections to the Magistrate Judge's finding that petitioners' default was excusable because they had been abandoned by their former counsel, and respondent did not appeal that ruling to the Second Circuit. Therefore, when petitioners were allowed to pursue limited discovery on a particular issue, petitioners' allegations were found to be accurate.

In an Order dated November 5, 2002, the District Court: (a) denied petitioners' objections to the Magistrate Report, and denied petitioners' alternative application for a discovery remand on the issue of a meritorious defense or related counterclaim; (b) adopted all of the findings of fact and conclusions of law set forth in the Magistrate Report; and (c) denied the motion to vacate the default judgment on the ground that petitioners had not established a "meritorious defense or related counterclaim" under New York law and/or there would be an "impermissible level of prejudice" to respondent if the Default Judgment were vacated. *See* Appendix C. Petitioners timely appealed to the Second Circuit, bringing up for appellate review both this final order and all interlocutory rulings in the case.

Several months later, petitioners finally located a duplicate original version of an authentic, fully-executed 1999 letter-agreement, signed in blue ink by respondent's officer, in which respondent had acknowledged and confirmed, several years *prior* to this lawsuit, that at least four petitioners were *not guarantors* under a 1996 Guaranty Agreement (the "Withheld Guarantor Evidence"). *See* Appendix I. Thus, the Withheld Guarantor Evidence indicates that these four petitioners are *not liable* for more than $80 million to respondent. Although petitioners had previously maintained that these four petitioners are not liable as guarantors, petitioners had been unable to establish the same because: (a) they had misplaced their duplicate original version of the Withheld Guarantor Evidence in their files; (b) respondent had not voluntarily produced [and may have concealed] its duplicate original version of the Withheld Guarantor Evidence; and (c) the District Court had not allowed petitioners to obtain any merits-related discovery from respondent or anyone else.

By Notice of Motion dated February 6, 2003, prior to the perfection of an appeal from the final order determining the first vacatur motion, petitioners submitted extensive affidavits and exhibits seeking post-judgment vacatur relief based upon: (a) their having located a duplicate original version of the Withheld Guarantor Evidence acknowledging that four petitioners are not liable for more than $80 million as guarantors to respondent; and (b) respondent's failure, throughout this case, to inform the Court of the existence of the Withheld Guaranbtor Evidence. Petitioners' motion was predicated upon FRCP 60(b) for fraud on the court, or FRCP 60(b)(3) for fraud or other litigation-misconduct by an adverse party.

Respondent's opposition: (a) notably failed to contain any affidavits from the officer [Kelley Rumps] who had executed the 1999 letter-agreement on behalf of respondent, or the other officer [Dan Lobdell] to whom the 1999 letter-agreement had been sent by petitioners for execution [*see* Appendix I]; (b) notably failed to controvert the authenticity of the 1999 letter-agreement; (c) claimed that Ms. Rumps and Mr. Lobdell were no longer "currently employed" by respondent, but no addresses or contact information for such "former" bank officers were provided, presumably to prevent petitioners from uncovering further information regarding respondent's nondisclosure misconduct; and (d) consisted of a perfunctory three-page affidavit from a different officer who did *not* claim to have personal knowledge of the circumstances concerning the 1999 letter-agreement, and who merely stated in cryptic fashion that he had "supervised a review" of respondent's "files" but that particular officer had not located the same.

Respondent's opposition neither specifically admitted, nor specifically controverted, the authenticity of the 1999 letter-agreement. Instead, respondent essentially ignored the 1999 letter-agreement. Thus, petitioners filed an application with the District Court seeking an order directing respondent to provide addresses or contact information for Ms. Rumps and

Mr. Lobdell so that they could be subpoenaed. However, the District Court summarily denied that application as "immaterial."

Since the authenticity of the 1999 letter-agreement has never been challenged by anyone, on behalf of respondent, who actually has personal knowledge regarding the existence and execution thereof, the record reveals, *inter alia*, that:

(a) Throughout this case, respondent failed to disclose the existence of the Withheld Guarantor Evidence to the Court, even though (i) that authentic instrument provides that at least four petitioners are not liable as guarantors under the 1996 Guaranty Agreement and (ii) respondent was legally obligated to address the existence and effect of that authentic 1999 letter-agreement in its complaint and/or its motion papers seeking a default judgment and/or in connection with the magistrate judge hearing and/or in its other submissions to the Court herein;

(b) Throughout this case, respondent misrepresented to the Court that these four petitioners are "liable" under the 1996 Guaranty Agreement, and concealed the fact that (i) prior to this lawsuit, respondent had executed the authentic 1999 letter-agreement, (b) the authentic 1999 letter-agreement provides that four petitioners are not liable as guarantors under the 1996 Guaranty Agreement and (c) Ms. Rumps and Mr. Lobdell, who were involved in the execution and approval of the authentic 1999 letter-agreement for respondent, are now suddenly "unavailable" and no longer "currently employed" by respondent; and

(c) The respondent's misconduct induced the Court to enter, and thereafter sustain, a legally unauthorized default money judgment against four non-liable petitioners for more than $80 million under the 1996 Guaranty Agreement.

Finally, on February 6, 2003, petitioners also separately moved under FRCP 60(b)(4) seeking to vacate the Default

Judgment as void, as having been entered in violation of due process, based upon all and/or any one of the following reasons: (a) although respondent's complaint seeks unliquidated damages "in an amount to be determined at trial," the District Court issued a Default Judgment awarding about $140 million in damages without affording petitioners a due-process opportunity to challenge the damage amount at an evidentiary hearing; (b) the damage amount includes sizable requested sums for variable "make whole amounts" linked to fluctuating market indices, but respondent failed to furnish the necessary extrinsic proof regarding those fluctuating market indices, or as to how those variable amounts were calculated; and (c) the entire damage amount against the obligor was also imposed against the guarantor petitioners, "jointly and severally," even though the unsecured Guaranty Agreements only impose liability on the guarantor petitioners for a capped percentage of the debt and respondent furnished no proof in its default judgment motion papers that the capped percentages of the debt could not be collected from the guarantor petitioners.

By order dated April 17, 2003, the District Court summarily denied petitioners' second vacatur motion. *See* Appendix B. In so doing, the District Court failed to address several federal law issues concerning the requirement of a due process evidentiary hearing for the purpose of resolving disputes, on a vacatur motion under FRCP 60(b) for fraud on the Court or under FRCP 60(b)(3) for fraud, misrepresentation or misconduct by an adverse party. The absence of an evidentiary hearing is particularly troubling, for due process purposes, because the record reveals that: (a) the countersigned 1999 letter-agreement exonerates four petitioners from more than $80 million in guarantor damages [Appendix I]; (b) in response to the vacatur motion, the bank officer who executed the countersigned 1999 letter-agreement did *not* dispute that said officer had executed the same; (c) in response to the vacatur motion, respondent did not even specifically controvert the authenticity of the countersigned 1999 letter-agreement; and (d) prior to the vacatur motion, respondent had failed to disclose the existence of the countersigned 1999 letter-agreement to the Court throughout this case. The District Court also essentially ignored petitioners' due-process arguments that the entry of a Default Judgment for about $140 million in damages is void pursuant to FRCP 60(b)(4), FRCP 54(c) and FRCP 55(b)(2) because, prior thereto, petitioners had not been afforded a due process opportunity to challenge that damage amount at an evidentiary hearing. The absence of an evidentiary hearing is particularly troubling, for due process purposes, because the record reveals that: (a) respondent's complaint requests damages "in an amount to be determined at trial"; (b) petitioners, without any opportunity for cross-examination, were subjected to a substantial damage award for variable "make whole amounts" linked to fluctuating market indices; and (c) the entire damage award was imposed against certain guarantor petitioners "jointly and severally" even though they are only responsible for a capped percentage of the debt under the Guaranty Agreements.

Petitioners timely filed a notice of appeal from this second vacatur order. By order dated May 14, 2003, the Second Circuit consolidated the appeals from the two vacatur orders issued by the District Court. By opinion, dated June 15, 2004, the Second Circuit affirmed the District Court's vacatur orders based upon, it is respectfully submitted, a misapplication of controlling federal law. *See* Appendix A.

As set forth below, the Second Circuit's ruling conflicts with the precedent of this Court on several issues of federal law and, therefore, the ruling must be reversed. Since this is a diversity case, controlling federal law also requires the application of state law on certain issues. As set forth below, the Second Circuit's ruling incorrectly applied federal law to certain state law issues and, therefore, the ruling must be reversed.

REASONS FOR GRANTING THE PETITION

I. Review Is Warranted In This Diversity Case Because The Second Circuit's Ruling:

(A) Incorrectly Applies A Federal Law Standard In The Default Judgment Context To Sustain A Massive Damages Award For About $140 Million, On A State-Created Claim, In Violation Of New York's State Law Standard; And

(B) Conflicts With This Court's "Erie Progeny" Precedent In *Gasperini v. Center For Humanities, Inc.*, 518 U.S. 415 (1996), Which Directs That A Damages Recovery On A State-Created Claim In A Federal Court Diversity Case Cannot Exceed The Damages Recovery That Could Be Obtained On That State-Created Claim In State Court.

In *Gasperini v. Center for Humanities, Inc.*, 518 U.S. 415, 430, 437 n.22, 438 (1996), this Court, in a damage context after trial in a federal court diversity case, stated that:

> (a) "Just as the *Erie* principle precludes a federal court from giving a state-created claim 'longer life . . . than [the claim] would have had in the state court,' *Ragan*, 337 U.S. at 533-34, 69 S. Ct. at 1235, so *Erie* precludes a recovery in federal court significantly larger than the recovery that would have been tolerated in state court." [at 430];
>
> (b) "[W]hen New York substantive law governs a claim for relief, New York law and decisions guide the allowable damages." [at 437];
>
> (c) "Whether damages are excessive for the claim-in-suit must be governed by *some* law. And there is no candidate for that governance other than the law that gives rise to the claim for relief - - here, the law of New York. *See* 28 U.S.C. §§ 2072(a) and (b) ('Supreme Court shall have the power to prescribe general rules of . . . procedure'; '[s]uch rules shall not abridge, enlarge or modify any substantive right'); *Browning-Ferris*, 492 U.S. at 279, 109 S. Ct. at 2922 ('standard of excessiveness' is a 'matte[r] of state, and not federal common law'); *see also* R. Fallon, D. Meltzer, & D. Shapiro, Hart and Wechsler's

The Federal Courts and the Federal System 729-30 (4th ed. 1996) (observing that Court 'has continued since [*Hanna v. Plumer*, 380 U.S. 460, 85 S. Ct. 1136, 14 L. Ed. 2d 8 (1965),] to interpret the federal rules to avoid conflict with important state regulatory policies,' citing *Walker v. Armco Steel Corp.*, 446 U.S. 740, 100 S. Ct. 1978, 64 L. Ed. 2d 659 (1980)." [*Id.* n.22]; and

(d) "In light of *Erie's* doctrine, the federal appeals court must be guided by the damage-control standard state law supplies . . ." [at 438].

In *Gasperini*, the federal courts incorrectly applied a federal law standard to a damage award on a state-created claim, in a diversity case, *after a trial*. Here, the federal courts incorrectly applied a federal law standard to a damage award on a state-created claim, in a diversity case, *without a trial or evidentiary hearing and in the context of a default judgment*. Accordingly, for purposes of substantive due process under the Fifth Amendment to the U.S. Constitution, it is respectfully submitted that, in a diversity case, state-created damage standards must always govern the adjudication of a state-created claim, irrespective of the particular litigation posture of a particular diversity case before the federal court.

Contrary to this Court's decision in *Gasperini*, the Second Circuit, in this diversity case, incorrectly applied a federal law standard in the default judgment context, and incorrectly refused petitioners' demand for an evidentiary hearing, in sustaining a massive damage award of about $140 million on a state-created claim. However, the Second Circuit's federal law approach: (a) violates well-established New York state law standards regulating damage awards in the default judgment context; and (b) would not have been applied had this litigation been pursued in New York's state courts.

First, New York law provides, by statute, that "The [default] judgment shall not exceed in amount or differ in type from that demanded in the complaint . . ."[2] Respondent's diversity complaint sought unliquidated damages "in an amount to be determined at trial." Thus, the Second Circuit contravened New York law by sustaining a default judgment that contains a specific amount of damages (here, a massive amount of about $140 million), even though no particularized damage amount was sought in the complaint and petitioners were not afforded their due process right to challenge the "damage proof" subsequently adduced by respondent at an evidentiary hearing.

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[2] New York CPLR 3215(b); *see also Slote v. Cascade Holding Corp.*, 276 N.Y. 239, 245 (N.Y. 1937)

> On the other hand, though it is true that a judgment in favor of the plaintiff in the [ ] action for the relief demanded in the complaint is

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Second, New York law typically requires that a defaulting defendant must be afforded a due-process right, at an evidentiary hearing, to challenge the amount of requested damages, to cross-examine plaintiff's damage witnesses, and to offer proof of any matters that might serve to mitigate the amount of damages.[3] Here, the absence of an evidentiary

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> as conclusive upon parties to the action, though they failed to interpose a defense, as the judgment would have been if the defense had been litigated, yet it is also true that the failure to interpose an answer cannot enlarge the scope of the issues tendered by the complaint or permit a judgment 'more favorable to the plaintiff than that demanded in the complaint' [cit. om.].

[3] *See, e.g., Amusement Business Underwriters v. American Int'l Group, Inc.*, 66 N.Y.2d 878, 880 (1985)

> Although a defaulting defendant admits all traversable allegations in the complaint, including the basic issue of liability, an allegation of damage is not a traversable allegation and, therefore, a defaulting defendant does not admit the plaintiff's conclusion of damages but may, at an inquest, offer proof in mitigation of damages if it involves 'circumstances intrinsic to the transactions at issue' in the plaintiff's complaint [cits. om.].

Reynolds Securities, Inc. v. Underwriters Bank and Trust Company, 44 N.Y.2d 568, 572 (1978) (defaulting defendant is typically entitled to a damages hearing with "a full opportunity to cross-examine witnesses, give testimony and offer proof in mitigation of damages [cits. om.]."); *McClelland v. Climax Hosiery Mills*, 252 N.Y. 347, 351, 354 (N.Y. 1930)

> An allegation of damage is not, however, a traversable allegation [cit. om.]. It is not admitted by a defendant's failure to answer [cits. om.]. Upon an assessment of damages, a defendant who has served a notice of appearance [like petitioners in this diversity case] is entitled to notice of the assessment, to appear and cross-examine the plaintiff's witnesses, and to offer testimony upon the question

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hearing is particularly troubling, for due process purposes, because the record reveals that: (a) respondent's complaint requests damages "in an amount to be determined at trial;" (b) petitioners have been subjected to a substantial damage award for variable "make whole amounts" linked to fluctuating market indices, but respondent failed to adduce any documentary proof regarding those fluctuating market indices, and petitioners were not afforded an opportunity to cross-examine respondent's in-house damage witness (a bank officer) on the same; and (c) certain guarantor petitioners have been subjected to a damage award for the entire debt, "jointly and severally," even though such guarantors are only responsible for a capped percentage of the debt under the Guaranty Agreements.

Therefore, review of the Second Circuit's ruling is warranted in order to clarify that, for purposes of a state-created claim in a diversity case; (a) state law damage standards (not federal law damage standards) govern an adjudication of the extent of a damage recovery *in the default judgment context*; (b) all state law standards that affect the amount of damages that can be imposed against a defendant, whether by default or otherwise, constitute a "substantive" or "outcome affective" issue for purposes of *Erie* and/or 28 U.S.C. § 1652; and (c) the substantive due process clause of the Fifth Amendment to the U.S. Constitution, and the "dual sovereignty" principles upon which the U.S. Constitution was based,[4] both require that federal courts should scrupulously

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> of damages, not for the purpose of defeating the plaintiff's cause of action in toto, because he has admitted the cause of action by failing to answer and plaintiff is entitled, in any event, to nominal damages. The [defendant's] testimony is competent, however, for the purpose of assisting the court in fixing the real damages suffered by the plaintiff [cits. om.] . . . The procedure upon an assessment of damages by the court is not specified in the Civil Practice Act and general rules must be held to apply [cits. om.].

[4] *See, e.g., Printz v. United States*, 521 U.S. 898, 918-921 (1997) where this Court stated that

> It is incontestable that the Constitution established a system of 'dual sovereignty.' [cit. om.] Although the States surrendered many of

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avoid reliance upon the Federal Rules of Civil Procedure in the diversity "sphere" whenever such Federal Rules may conflict with the applicable state law damage standard. *See, e.g., Gasperini*, 518 U.S. at 430, 438 where this Court stated:

> "We therefore agree with the Second Circuit [in the context of a jury verdict on the amount of compensatory damages] that New York's check on excessive damages implicates what we have called *Erie's* 'twin aims.' See *supra*, at 2220. [FN 12]
>
> FN 12. For rights that are state created, state law governs the amount properly awarded as punitive damages, subject to an ultimate federal constitutional check for exorbitancy [cits. om.] An evenhanded approach would require federal-court deference to endeavors like New

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their powers to the new Federal Government, they retained 'a residuary and inviolable sovereignty' [cit. om.]. This is reflected throughout the Constitution's text [cits. om.] . . . Residual state sovereignty was also implicit, of course, in the Constitution's conferral upon Congress of not all governmental powers, but only discrete, enumerated ones, Art. I, §8, which implication was rendered express by the Tenth Amendment's assertion that '[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people' . . . Preservation of the States as independent political entities being the price of union . . . the Framers rejected the concept of a central government that would act upon and through the States, and instead designed a system in which the state and federal governments would exercise concurrent authority over the people . . . The great innovation of this design was that our citizens would have two political capacities, one state and one federal, each protected from incursion by the other - - 'a legal system unprecedented in form and design, establishing two orders of government, each with its own direct relationship, its own privity, its own set of mutual rights and obligations to the people who sustain it and are governed by it.' [cit. om.] . . . This separation of the two spheres is one of the Constitution's structural protections of liberty. 'Just as the separation and independence of the coordinate branches of the Federal Government serve to prevent the accumulation of excessive power in any one branch, a healthy balance of power between the States and the Federal Government will reduce the risk of tyranny and abuse from either front.' [cit. om.]

York's to control compensatory damages for excessiveness. *See infra,* at 2223 n.18. Just as the *Erie* principle precludes a federal court from giving a state-created claim 'longer life . . . than [the claim] would have had in the state court,' *Ragan,* 337 U.S., at 533-534, 69 S. Ct., at 1235, so *Erie* precludes a recovery in federal court significantly larger than the recovery that would have been tolerated in state court . . . In light of *Erie's* doctrine, the federal appeals court must be guided by the damage-control standard state law supplies . . ." [5]

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[5] *See also, e.g., Semtek Int'l Inc. v. Lockheed Martin Corp.,* 531 U.S. 497, 508-09 (2001) (In holding that a state law claim-preclusion standard governs the legal effect of a federal court's diversity judgment, this Court stated:

> Since state, rather than federal, substantive law is at issue there is no need for a uniform federal rule. And indeed, nationwide uniformity in the substance of the matter is better served by having the same claim-preclusive rule (the state rule) apply whether the dismissal has been ordered by a state or a federal court. This is, it seems to us, a classic case for adopting, as the federally prescribed rule of decision, the law that would be applied by state courts in the State in which the federal diversity court sits [cits. om.].

Guaranty Trust Co. of New York v. York, 326 U.S. 99, 108-09 (1945) where this Court stated:

> But since a federal court adjudicating a state-created right solely because of the diversity of citizenship of the parties is for that purpose, in effect, only another court of the State, it [the federal court] cannot afford recovery if the right to recover is made unavailable by the State nor can it substantially affect the enforcement of that right as given by the State . . . [and] It is therefore immaterial whether statutes of limitation are characterized either as 'substantive' or 'procedural' in State court opinions in any use of those terms unrelated to the specific issue before us. Erie R. Co. v. Tompkins was not an endeavor to formulate scientific legal terminology. It expressed a policy that touches vitally the proper distribution of judicial power between the State and federal courts. In essence, the intent of that decision was to insure that, in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the outcome of the litigation in the federal court should be substantially the same, so far as legal rules determine the outcome of a litigation, as it would be if tried in a State court. The nub of the policy that underlies Erie R. Co. v. Tompkins is that for the same transaction the accident of a suit . . .

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II. Review Is Also Warranted Because Even If, *Arguendo,* Federal Law Applies To The Default Judgment, The Second Circuit's Ruling Violates Federal Due Process Principles Under FRCP 54(c) And FRCP 55(b)(2).

FRCP 54(c) is not discretionary and mandates that "A judgment by default shall not be different in kind from or exceed in amount that prayed for in the demand for judgment."[6] FRCP 55(b)(2) is discretionary and authorizes the court to conduct an evidentiary hearing "to determine the amount of damages or to establish the truth of any averment by evidence or to make an investigation of any other matter."[7] The Fifth Amendment to the U.S. Constitution also prohibits the deprivation of property without due process of law.

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> in a federal court [due to diversity of citizenship] instead of in a State court a block away, should not lead to a substantially different result.

Pueblo Trading Co. v. El Camino Irr. Dist., 169 F.2d 312 (9th Cir. 1948) (if a federal diversity court awards relief "beyond the scope of the complaint," then "to that extent the judgment, being by default, was a nullity") (citing to California's state law standard in the default judgment context).

[6] FRCP 54(c) appears to be a modern codification of the prior common law rule in federal practice. *See, e.g., Ohio Cent. R. Co. v. Central Trust Co.*, 133 U.S. 83, 90-91 (1890) where this Court stated: "The bill was taken as confessed; but that fact did not, in itself, justify giving complainant more than it claimed. . . and hence, if a decree be passed not confined to the matter of the bill, it may be attacked on appeal for that reason."; *Compton v. Alton Steamship Company, Inc.*, 608 F.2d 96, 104-06 and collecting cases in n.16 (4th Cir. 1979) (a federal default judgment is void under FRCP 54(c), and must be vacated, whenever it contains a damage amount that is different from what is requested in the complaint).

[7] FRCP 55(b)(2) appears to be a modern codification of the prior common law rule in federal practice. *See, e.g., Thomson v. Wooster,* 114 U.S. 104, 111, 5 S. Ct. 788 (1885)

> [B]ut where the matter sued for consists in damages, a judgment interlocutory is given; after which a writ of inquiry goes to ascertain the damages, and then the judgment follows [cit. om.]. The strict analogy of this proceeding in actions of law to a general decree *pro confesso* in equity in favor of the complainant, with a reference to a master to take a necessary account, or to assess unliquidated damages, is obvious and striking.

Since respondent's complaint requested damages "in an amount to be determined at trial" - - and petitioners were not allowed to challenge the damage amount at a trial or evidentiary hearing - - the Default Judgment of about $140 million sustained by the Second Circuit is void under FRCP 54(c) and must be vacated pursuant to the federal due process principles incorporated therein. *See Klapprott v. United States*, 335 U.S. 601, 609 (1949) where this Court stated that "The judgment is void if the hearing of evidence is a legal prerequisite to rendition of a valid default judgment . . ."

Moreover, the absence of an evidentiary hearing is particularly troubling, for due process purposes, because the record reveals that: (a) respondent's complaint requests damages "in an amount to be determined at trial;" (b) petitioners have been subjected to a substantial damage award for variable "make whole amounts" linked to fluctuating market indices, but respondent failed to adduce any documentary proof regarding those fluctuating market indices, and petitioners were not afforded an opportunity to cross-examine respondent's in-house damage witness (a bank officer) on the same; and (c) certain guarantor petitioners have been subjected to a damage award for the entire debt, "jointly and severally," even though such guarantors are only responsible for a capped percentage of the debt under the Guaranty Agreements. Therefore, the Default Judgment of about $140 million sustained by the Second Circuit also is void under FRCP 55(b)(2) and must be vacated pursuant to the federal due process principles incorporated therein. See *Klapprott v. United States*, 335 U.S. 601, 609, 611 (1949) where this Court stated that "The judgment is void if the hearing of evidence is a legal prerequisite to rendition of a valid default judgment . . ." [and] "Thus it appears that statutes and rules have largely left for judicial determination the type of cases in which hearings and proof should precede default judgments. In this situation, it is the final responsibility of this Court to formulate the controlling rules for hearings and proof [cit. om.]."

III. Review Is Also Warranted Because The Second Circuit Violated *Klapprott v. United States,* 335 U.S. 601 (1949), By Ruling That Even If, *Arguendo,* The Massive Default Judgment Is Void, That Void Judgment Will Nonetheless Remain "Valid" Because An "Untimely" Vacatur Motion Under FRCP 60(b)(4) Was Made 15 Months After The Entry Thereof.

In *Klapprott,* this Court vacated a void judgment four years after it had been entered. Similarly, there are federal appellate decisions, outside the Second Circuit, which hold that: (a) "there is no time limit on an attack on a judgment as void;" (b) "the requirement that the [vacatur] motion be made within a 'reasonable time,' which seems literally to apply to motions under Rule 60(b)(4), cannot be enforced with regard to this class of motion;" (c) "a void judgment cannot acquire validity because of laches on the part of the judgment debtor;" and (d) "we review *de novo* a district court's ruling upon a Rule 60(b)(4) motion to set aside a judgment as void because the question of the validity of a judgment is a legal one."[8] It is also submitted that the Due Process Clause of the Fifth Amendment to the U.S. Constitution prohibits a result whereby a void judgment - - to wit: a judgment that was invalid when it was originally entered - - would nonetheless be allowed to remain "valid" merely through the passage of time.

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[8] *See, e.g., Harper MacLeod Solicitors v. Keaty & Keaty,* 260 F.3d 389, 394 (5th Cir. 2001) ("Rule 60(b)(4) motions leave no margin for consideration of the district court's discretion as the judgments themselves are by definition either legal nullities or not [cit. om.]."); *Export Group v. Industries, Inc.,* 54 F.3d 1466, 1469 (9th Cir. 1995) (*de novo* review of a motion seeking to vacate a judgment as void under FRCP 60(b)(4)); *New York Life Ins. Co. v. Brown,* 84 F.3d 137, 142-43 (5th Cir. 1996)

> [T]here is no time limit on an attack on a judgment as void. The one-year limit applicable to some Rule 60(b) motions is expressly inapplicable, and even the requirement that the motion be made within a 'reasonable time,' which seems literally to apply to motions under Rule 60(b)(4), cannot be enforced with regard to this class of motion [cit. om.] [quoting 11 Charles Alan Wright, Arthur R. Miller and Mary Kay Kane, *Federal Practice and Procedure* § 2862].

Here, the Second Circuit determined that even if, *arguendo,* the Default Judgment was void, that void default judgment will nonetheless remain "valid" because an "untimely" vacatur motion under FRCP 60(b)(4) was made only 15 months after the entry thereof. Since the Second Circuit's ruling conflicts with this Court's precedent in *Klapprott* [void judgment vacated by this Court four years after it was entered], and conflicts with the better-reasoned precedent from other circuits, the void default judgment herein for about $140 million must be vacated under FRCP 60(b)(4), and cannot be allowed to remain "valid" as a matter of constitutional due process. Therefore, review is warranted in order to clarify this Court's precedent on this federal law issue. *See, e.g., Klapprott,* 335 U.S. at 609 ("The [four year old] judgment is void if the hearing of evidence is a legal prerequisite to rendition of a valid default judgment . . ."); *Cleveland Board of Education v. Loudermill,* 470 U.S. 532, 542 (1985) ("We have described the 'root requirement' of the Due Process Clause as being 'that an individual be given an opportunity for a hearing *before* he is deprived of any significant property interest.' [cits. om.]."); 28 U.S.C. § 2072(b) ("Such rules [of federal civil procedure] shall not abridge, enlarge or modify any substantive right.").

IV. Review Is Also Warranted Because The Second Circuit Violated This Court's Precedent In *Hazel-Atlas Glass Co. v. Hartford-Empire Co.,* 322 U.S. 238 (1944), By Ruling That Petitioners Are Not Entitled To An Evidentiary Hearing Even If, *Arguendo,* Respondent Intentionally Concealed From The Court A Countersigned Version Of A Letter-Agreement Wherein Respondent Indicated That Certain Petitioners Are *Not Liable* As Guarantors For More Than $80 Million.

In *Hazel-Atlas Glass Co. v. Hartford-Empire Co.,* 322 U.S. 238, 249-50 n.5, and 250-51 (1944), this Court held that: (a) charges of litigation-misconduct cannot, "if in dispute, be finally determined on ex parte affidavits without examination and cross examination of witnesses" [322 U.S.

at 249-50 n.5]; and (b) a judgment debtor's prior lack of diligence in exposing the misconduct does not prevent the Court from vacating the judgment: "Surely it cannot be that preservation of the integrity of the judicial process must always wait upon the diligence of litigants. The public welfare demands that the agencies of public justice be not so impotent that they must always be mute, and helpless victims of deception and fraud." [322 U.S. at 250-51]. Moreover, several federal circuits have held that evidentiary proceedings are warranted in the context of asserted litigation-misconduct where, as here, the record suggests an "inference of fraud" or a "colorable claim" of litigation-misconduct.[9]

Appendix I consists of the "Withheld Guarantor Evidence" - - to wit: a duplicate original version of an authentic, fully-executed 1999 letter-agreement, signed in blue ink by respondent's officer, in which respondent had acknowledged and confirmed, several years *prior* to this lawsuit, that at least four petitioners were *not guarantors* under a 1996 Guaranty Agreement. The Withheld Guarantor Evidence indicates that these four petitioners are *not liable* for more than $80 million to respondent. During the initial vacatur motion, petitioners had maintained that these four petitioners are not liable as guarantors but, unfortunately, petitioners had been unable to establish the same because: (a) they had misplaced their duplicate original version of the Withheld Guarantor Evidence in their files; (b) respondent had not voluntarily produced [and may have concealed] its duplicate original version of the Withheld Guarantor Evidence; and (c) the District Court had not allowed petitioners to obtain any merits-related discovery from respondent [thereby preventing petitioners from using alternative means to produce a copy of the Withheld Guarantor Evidence on the initial vacatur motion]. Respondent's opposition to the second vacatur motion: (a) notably failed to contain any affidavits from the officer [Kelley Rumps] who had executed the 1999 letter-agreement on behalf of respondent, or the other officer [Dan Lobdell] to whom the 1999 letter-agreement had been sent by petitioners for execution [*see* Appendix I]; (b) notably failed to controvert the authenticity of the 1999 letter-agreement; (c) claimed that Ms. Rumps and Mr. Lobdell were no longer "currently employed" by respondent, but no addresses or contact information for such "former" bank officers were provided, presumably to prevent petitioners from uncovering further information regarding respondent's nondisclosure misconduct; and (d) consisted of a perfunctory three-page affidavit from a different officer who did *not* claim to have personal knowledge of the circumstances concerning the 1999 letter-agreement, and who merely stated in cryptic fashion that he had "supervised a review" of respondent's "files" but that particular officer had not located the same.

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[9] *See, e.g., Pearson v. First NH Mortgage Corp.*, 200 F.3d 30, 35 (1st Cir. 1999) (factfinding proceedings warranted where the evidence at issue suggests a "colorable claim" of litigation misconduct); *Britton v. Swift Transportation Company, Inc.*, 127 F.3d 616, 619 (7th Cir. 1997) (Rule 60(b) vacatur motion was remanded for factfinding proceedings where the evidence at issue suggests an "inference of fraud" in the conduct of the litigation).

Since the authenticity of the 1999 letter-agreement has never been specifically controverted by anyone, on behalf of respondent, who actually has personal knowledge regarding the existence and execution thereof, the record reveals, *inter alia,* that:

> (a) Throughout this case, respondent failed to disclose the existence of the Withheld Guarantor Evidence to the Court, even though (i) that authentic instrument provides that at least four petitioners are not liable as guarantors under the 1996 Guaranty Agreement and (ii) respondent was legally obligated to address the existence and effect of that authentic 1999 letter-agreement in its complaint and/or its motion papers seeking a default judgment and/or in connection with the magistrate judge hearing and/or in its other submissions to the Court herein;

(b) Throughout this case, respondent misrepresented to the Court that these four petitioners are "liable" under the 1996 Guaranty Agreement, and concealed the fact that (i) prior to this lawsuit, respondent had executed the authentic 1999 letter-agreement, (b) the authentic 1999 letter-agreement provides that four petitioners are not liable as guarantors under the 1996 Guaranty Agreement and (c) Ms. Rumps and Mr. Lobdell, who were involved in the execution and approval of the authentic 1999 letter-agreement for respondent, are now suddenly "unavailable" and no longer "currently employed" by respondent; and

(c) The respondent's misconduct induced the Court to enter, and thereafter sustain, a legally unauthorized default money judgment against four non-liable petitioners for more than $80 million under the 1996 Guaranty Agreement.

Thus, the record evidence undeniably suggests, at a minimum, a "colorable claim" of litigation misconduct - - under FRCP 60(b) for fraud on the Court or under FRCP 60(b)(3) for fraud, misrepresentation or other misconduct by an adverse party - - directly affecting whether or not four petitioners are liable for more than $80 million as purported "guarantors" under the 1996 Guaranty Agreement. Nonetheless, the Second Circuit ruled that even if, *arguendo,* respondent had intentionally concealed from the Court the existence of a countersigned version of the 1999 letter-agreement, wherein respondent had acknowledged that four petitioners are *not liable* as guarantors for more than $80 million under the 1996 Guaranty Agreement, such evidence does not justify any factfinding proceedings of any kind regarding the propriety of that damage award of more than $80 million. Hence, review is warranted because the Second Circuit's ruling conflicts with *Hazel-Atlas, supra,* where this Court applied federal due process principles and directed that even disputed charges of litigation-misconduct can only be resolved, on a vacatur motion, through appropriate factfinding proceedings.

V. Review Is Also Warranted In This Diversity Case Because The Second Circuit Ignored Controlling New York Law Establishing That Petitioners Had Alleged A Meritorious Defense Or Counterclaim Sufficient To Vacate The Liability Default. In The Alternative, Certification Of This State-Law Issue, Affecting More Than $140 Million On The Merits, For An Authoritative State Court Resolution Is Warranted.

Prior to this litigation, respondent [as unsecured creditor] and petitioners [as debtors or guarantors] entered into unsecured financing agreements providing, *inter alia,* that New York law shall govern their commercial relations and disputes, and a proposed asset-sale generally needs respondent's "consent." Prior to the entry of a judgment on the merits, New York law prohibits an unsecured creditor from interfering with the use of unencumbered property belonging to its debtor.[10] Petitioners asked that respondent "consent" to a $140 million asset-sale to a ready, willing and able buyer so that: (a) $53 million of the sale-proceeds could be used to satisfy senior secured creditors with prior liens against the assets; and (b) all of the remaining $87 million in unsecured proceeds could be paid to respondent on account of the unsecured debt. Despite its unsecured status, respondent refused to "consent" to the asset-sale even though respondent would have received the entire amount of the unsecured proceeds therefrom, and respondent's contractual rights to collect the balance under the unsecured agreements would have remained legally intact. Since petitioners alleged that respondent sought to renegotiate the terms of the unsecured agreements by withholding its "consent" unless petitioners granted a security interest to the unsecured respondent in unencumbered property - - and an unsecured creditor is legally unauthorized to impose such a "consent condition" under these circumstances - - petitioners alleged a meritorious defense or counterclaim sufficient to vacate the liability default under controlling New York appellate law.[11]

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[10] *See Credit Agricole Indosuez v. Rossiyskiy Kredit Bank,* 94 N.Y.2d 541, 549 (N.Y. 2000) (New York law); *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.,* 527 U.S. 308, 319-20 (1999) (federal equity law).

Pursuant to the constitutionally-based *Erie* doctrine, the Second Circuit, in this diversity case, is required to apply New York substantive law as announced by the highest state court (or by the intermediate state appellate courts if the highest state court has not decided the issue). Yet, the Second Circuit rejected the merits of petitioners' argument to vacate the liability default on the basis of a single 1983 state trial court decision and one federal decision, but both of these decisions are not from New York's appellate courts and are otherwise inapplicable to the factual situation in the case at bar. Indeed, the Second Circuit failed to address, much less distinguish, the controlling decisions from the New York appellate courts which establish that petitioners alleged a legally sufficient defense or counterclaim under New York law. Since this Court essentially sits as a final "state court" on substantive issues in a diversity case - - and since petitioners have been exposed to a default judgment of more than $140 million based upon the lower federal courts' misapplication of New York law - - review is warranted to determine whether the liability default should be vacated under New York law so that petitioners can be afforded their due-process rights to pursue discovery from respondent concerning the merits.

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[11] *See, e.g., S&S Hotel Venture Limited Partnership v. 777 S.H. Corp.*, 108 A.D.2d 351, 351-56 (N.Y. App. Div. 1985) (upholding the legally sufficiency of a claim for breach of the bank's implied contractual obligation of good faith and fair dealing, under New York law, based upon allegations that the bank had arbitrarily withheld its consent to an asset-sale because the debtor would not accede to the bank's "consent condition" of renegotiating the terms of the preexisting loan agreement); *511 West 232nd Owners Corp. v. Jennifer Realty Co.*, 98 N.Y.2d 144, 153 (N.Y. 2002) (New York's highest state court held that a legally sufficient claim had been alleged for breach of the implied contractual obligation of good-faith and fair-dealing, under New York law, because that implied contractual obligation "encompasses any promises which a reasonable person in the position of the promisee [here, petitioners as a debtor or guarantors under an unsecured loan] would be justified in understanding were included [in the unsecured loan agreement]."); *Ashland Mgmt Inc. v. Janien*, 82 N.Y.2d 395, 402 (N.Y. 1993) (defining the scope of the contractual good-faith and fair-dealing obligation by reference to § 205 of the Restatement (2d) of Contracts); *Restatement (2d) of Contracts* ("bad faith" includes conduct "that violate[s] community standards of decency, fairness or reasonableness," such as "evasion of the spirit of the bargain," "abuse of a power to specify terms," and "interference with or failure to cooperate in the other party's performance"); *F&S Pharmacy, Inc. v. Dandra Realty Corp.*, 754 N.Y.S.2d 256, 257-58 (N.Y. App. Div. 1st Dep't 2003) (a legally sufficient claim was alleged because the contracting party's "insistence upon these terms [abuse of a power to specify terms] raises an issue [for trial] as to whether [it] breached the covenant of good faith and fair dealing implicit in all contracts.").

Alternatively, if this Court is uncertain as to whether petitioners have alleged a cognizable defense or counterclaim under New York law, then this Court should certify that state law issue to the New York State Court of Appeals for an authoritative determination. Indeed, as defendants: (a) petitioners have been compelled to litigate this state law case in federal court; and (b) petitioners have a constitutional due process right, under the Fifth Amendment to the U.S. Constitution, to avoid deprivation of their property rights under New York law, in the form of a massive default judgment in a diversity case for about $140 million, where there is no authoritative state court decision under New York law rejecting the merits of their state-created defense and counterclaim. Thus, review is alternatively warranted so that this Court, sitting as a "final state court" in this diversity case, can ensure that petitioners are not deprived of their property rights under New York law by lower federal courts that have not applied controlling New York substantive law on an issue with massive economic significance.[12]

CONCLUSION

For all the foregoing reasons, petitioners respectfully request that the Supreme Court grant review of this matter.

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[12] This Court has certified state-law issues for an authoritative determination by the state's highest court under various circumstances. *See, e.g., Arizonans for Official English v. Arizona*, 520 U.S. 43, 77 (1997) ("Through certification of novel or unsettled questions of state law for authoritative answers by a State's highest court, a federal court may save 'time, energy, and resources, and hel[p] build a cooperative judicial federalism' [cits. om.].").

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DECIDED JUNE 15, 2004

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

August Term, 2003

(Argued Dec. 19, 2003 Decided June 15, 2004)

Docket Nos. 02-9404, 03-7415

STATE STREET BANK AND TRUST COMPANY,

Plaintiff-Appellee,

v.

INVERSIONES ERRAZURIZ LIMITADA, (f/k/a Inversiones Errazuriz S.A.); SUPERMERCADOS UNIMARC S.A., (f/k/a Comercial E Inmobiliaria Unimarc S.A.), PESQUERA NACIONAL S.A., UNIMARC ABASTECIMIENTOS S.A., CIDEF S.A., SALMONES UNIMARC S.A., INDUSTRIA FORESTAL NACIONAL S.A., FORESTAL REGIONAL S.A., CIDEF ARGENTINA S.A., CORPORATION DE INVERSIONES Y DESARROLLO FINANCIERO CIDEF S.A., and SOCIEDAD CONTRACTUAL MINERA COMPANIA DE SALITRE Y YODO PRIMERA REGION, (f/k/a Compania De Salitre Y Yodo Primera Region S.A.),

Defendants-Appellants,

Appeal from the denial by the United States District Court for theSouthern District of New York, Carter, *J.*, of defendants-appellants' motions to vacate a default judgment. Affirmed.

MESKILL, *Circuit Judge.*

This appeal concerns the propriety of a multimillion dollar default judgment entered against defendants-appellants Inversiones Errazuriz Limitada, Supermercados Unimarc S.A., Pesquera Nacional S.A., Unimarc Abastecimientos S.A., Cidef S.A., Salmones Unimarc S.A., Industria Forestal Nacional S.A., Forestal Regional S.A., Cidef Argentina S.A., Corporacin de Inversiones y Desarrollo Financiero Cidef S.A., and Socieded Contractual Minera Compaia de Salitre y Yodo Primera Regin (collectively "defendants"). In April 2001, plaintiff-appellee State Street Bank and Trust Company ("State Street Bank" or "the bank") initiated a legal action to recover more than $100 million to which the bank was entitled pursuant to two credit agreements executed in 1994 and 1996 (individually and respectively the "1994 Credit Agreement" and the "1996 Credit Agreement" and collectively the "Credit Agreements"). When the defendants failed to respond to the complaint, the United States District Court for the Southern District of New York, Carter, *J.*, on the application of State Street Bank, entered a default judgment of approximately $136 million.[1] Thereafter, the defendants brought two motions to vacate the default judgment pursuant to various provisions of Rule 60(b) of the Federal Rules of Civil Procedure. The district court denied those motions and the defendants appealed.

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[1] This figure does not include the interest payments that also were awarded in the default judgment.

Defendants contend that the district court improperly denied their efforts to secure relief from the default judgment. Defendants claim that the defenses and counterclaims they asserted justified the vacatur of the default judgment and that State Street Bank would not be prejudiced if that judgment were vacated. They also contend that State Street Bank perpetrated a fraud that merited vacatur. For the reasons that follow, we conclude that the district court properly denied their Rule 60(b) motions and affirm the court's decisions.

BACKGROUND

The roots of the appeal before us can be traced to certain transactions that took place in 1994 and 1996. State Street Bank initially agreed to supply defendant Inversiones Errazuriz Limitida (Inverraz), a Chilean company, with $50 million in accordance with the terms of the 1994 Credit Agreement. Subsequently, Inverraz borrowed an additional $65 million from State Street Bank pursuant to the 1996 Credit Agreement.

State Street Bank entered into these financing arrangements on the express condition that certain operating affiliates of Inverraz would guarantee the loans. As such, various Inverraz subsidiaries signed guaranty agreements in 1994 and 1996 (individually and respectively the "1994 Guaranty Agreement" and the "1996 Guaranty Agreement" and collectively the "Guaranty Agreements"), making each of them liable for a share of the sums borrowed by Inverraz and for certain penalties if their parent company defaulted on the loans.[2]

According to the Credit Agreements, the sums borrowed by Inverraz were to be repaid, by and large, through several semiannual installments. Both Credit Agreements expressly provided that the failure to make timely payments would constitute an "Event of Default." If an Event of Default occurred, State Street Bank could accelerate Inverraz's debt such that all of the interest and principal outstanding with respect to the loan defaulted on, together with a defined "Make Whole Amount," would become immediately due and payable. Under the provisions of the Guaranty Agreements, each guarantor agreed to pay for a specified share of this accelerated debt.

In 1999 and 2000, Inverraz failed to make the semiannual installment payments required by the Credit Agreements. In response, State Street Bank accelerated Inverraz's debt and demanded repayment of all the sums then due. Nevertheless, neither Inverraz nor any guarantor repaid any portion of Inverraz's outstanding debt.

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[2] In this respect, Comercial e Inmobiliaria Unimarc S.A., Pesquera Nacional S.A., Cidef S.A., Salmones Unimarc S.A., and Industria Forestal Nacional S.A. signed a Guaranty Agreement pertaining to the 1994 Credit Agreement; in turn, each of the foregoing entities, as well as Compaia de Salitre y Yodo Primera Regin S.A. and Cidef Argentina S.A., also signed a Guaranty Agreement pertaining to the 1996 Credit Agreement. In addition, the 1996 Credit Agreement included provisions that allowed for the possibility that the identity of the guarantors responsible for the 1996 loan could change at specified times if certain financial criteria were met.

In April 2001, State Street Bank filed this legal action against the defendants in an effort to recover the sums to which it was entitled pursuant to the Credit Agreements and the Guaranty Agreements, as well as to secure a declaration that the defendants could not sell certain assets without the bank's prior consent.[3] The defendants did not immediately answer State Street Bank's complaint. Rather, in June 2001 the district court endorsed a stipulation in which the defendants acknowledged personal jurisdiction as well as service of process and State Street Bank agreed to extend the defendants' time to respond to the complaint. Notwithstanding this extension of time, the defendants failed to file an answer in the months that followed.

State Street Bank eventually moved for the entry of a default judgment and the district court granted the bank's motion. With respect to the 1994 Credit Agreement, the court issued a default judgment that held defendants Inverraz, Supermercados Unimarc S.A., Pesquera Nacional S.A., Unimarc Abastecimientos S.A., Cidef S.A., Salmones Unimarc S.A., Industria Forestal Nacional S.A., Forestal Regional S.A., and Corporacin de Inversiones y Desarrollo Financiero Cidef S.A. jointly and severally liable for $57,283,874.86 as well as for prejudgment interest from November 1, 2001, at the rate of $20,011.63 per day. As to the sums owed under the 1996 Credit Agreement, the court held defendants Inverraz, Supermercados Unimarc S.A., Pesquera Nacional S.A., Unimarc Abastecimientos S.A., Cidef S.A., Salmones Unimarc S.A., Cidef Argentina S.A., Corporacin de Inversiones y Desarrollo Financiero Cidef S.A., and Sociedad Contractual Minera Compaia de Salitre y Yodo Primera Regin jointly and severally liable for $79,180,000.12 as well as for prejudgment interest from November 1, 2001, at the rate of $21,599.47 per day. In addition, the court prohibited the defendants from selling or transferring the assets of Compaia de Salitre y Yodo de Chile S.A. without State Street Bank's prior consent.

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[3] State Street Bank brought this action against Inverraz as well as various defendants that it contends are liable as guarantors under the Guaranty Agreements. Some of the defendants—Pesquera Nacional S.A., Cidef S.A., Salmones Unimarc S.A., Industria Forestal Nacional S.A., and Cidef Argentina S.A.—were explicitly named as guarantors in those Guaranty Agreements. The bank contends that two of the defendants, Supermercados Unimarc S.A. and Sociedad Contractual Minera Compaia de Salitre y Yodo Primera Regin, were formerly known as, respectively, the named guarantors Comercial e Inmobiliaria Unimarc S.A. and Compaia de Salitre y Yodo Primera Regin S.A. In addition, State Street Bank brought this action against defendants Unimarc Abastecimientos S.A., Forestal Regional S.A., and Corporacin de Inversiones y Desarrollo Financiero Cidef S.A.; according to State Street Bank, these entities allegedly became liable as guarantors for the sums owed to the bank because they were successors-in-interest to certain of the original guarantors.

Thereafter, the defendants moved the district court to vacate the default judgment pursuant to various provisions of Rule 60(b) of the Federal Rules of Civil Procedure. They argued that the default in question had not been willful and that State Street Bank would not be prejudiced if the default judgment was vacated. They also advanced a host of defenses and counterclaims that allegedly justified the vacatur of the default judgment.

In February 2002, the district court held that two of those defenses and counterclaims were not meritorious. *See State*

Street Bank & Trust Co. v. Inversiones Errazuriz, Limitada, 230 F.Supp.2d 313, 319-24 (S.D.N.Y.2002) (*State Street Bank I*). However, the court determined that the "factual record regarding [the] defendants' seven remaining counterclaims [and defenses was] simply too incomplete for the court to conclude one way or the other whether they constitute meritorious defenses." *Id.* at 324. As such, the court referred the remaining counterclaims and defenses to a magistrate judge and directed him to issue a report and recommendation, after the defendants had "been given an opportunity to flesh out the factual foundation for each counterclaim [and defense]," with respect to whether they were meritorious. *Id.* The district court also found that there was not enough information, as of yet, for it to decide whether the default had been willful or whether State Street Bank would suffer prejudice in the event of vacatur. *See id.* at 318- 19, 324. Hence, the court also directed the magistrate judge to issue a report and recommendation evaluating these two issues following further briefing and factual inquiry. *See id.* at 324.

The magistrate judge responded to the district court's directives by holding a two day hearing in May 2002 and thereafter issued a report recommending that the district court deny the motion to vacate the default judgment. *See Street Bank & Trust Co. v. Inversiones Errazuriz Limitada,* 246 F.Supp.2d 231, 263 (S.D.N.Y.2002) (*State Street Bank II*). Although the magistrate judge found that the defendants' failure to respond to the complaint had not been willful, he nonetheless determined that their motion should be denied because they had failed to establish any meritorious defense or counterclaim and had failed to demonstrate that State Street

Bank would not be prejudiced by the vacatur of the default judgment. *Id.*

Defendants objected to several of the magistrate judge's determinations. The district court reviewed the issues and agreed with the magistrate judge that the remaining counterclaims and defenses were not meritorious and that the defendants had failed to demonstrate that State Street Bank would not be subjected to prejudice if the default judgment were vacated. Accordingly, the court denied the defendants' motion to vacate the default judgment. *See id.* at 243. The defendants filed an appeal challenging that decision.

Following the denial of their initial motion to vacate the default judgment and before we had an opportunity to consider their appeal therefrom, the defendants brought a second motion pursuant to various provisions of Rule 60(b). They did so in an effort to seek relief from both the district court's earlier decision in *State Street Bank II* as well as the underlying default judgment. Their second Rule 60(b) motion was predicated, for the most part, on a letter that the defendants discovered in their own files after the court denied their previous motion in *State Street Bank II.* Defendants argued that the information set forth in the letter established a meritorious defense and that the default judgment therefore should be vacated. They also contended that State Street Bank as well as its counsel withheld and concealed the letter from them, thereby both defrauding them and perpetrating a "fraud on the court" that justified relief pursuant to Rule 60(b) and Rule 60(b)(3). Finally, in addition to their reliance on the letter, the defendants asserted that the default judgment was void and relief therefrom should be granted pursuant to Rule

60(b)(4). The district court denied the defendants' second Rule 60(b) motion in its entirety. *See State Street Bank & Trust Co. v. Inversiones Errazuriz, Limitada,* 2003 WL 1907955, at *3 (S.D.N.Y. Apr.18, 2003) (*State Street Bank III*).

Defendants filed a timely appeal challenging the denial of their second Rule 60(b) motion. We consolidated their second appeal with their earlier appeal from the denial of their first Rule 60(b) motion and we now address the issues raised by these consolidated proceedings.

DISCUSSION

Defendants contend that the district court erroneously denied both of their Rule 60(b) motions. We review the denial of each of those motions seriatim.

I. *Defendants' First Motion to Vacate the Default Judgment*

In the proceedings below, the defendants advanced a host of defenses and counterclaims in support of their initial motion to vacate the default judgment pursuant to several provisions of Rule 60(b). On appeal, they focus on only two counterclaims and one defense and argue that the district court erroneously concluded that they were not meritorious. The defendants also contend that the district court erred in determining that they had failed to establish that State Street Bank would not be prejudiced by the vacatur of the default judgment.

Rule 60(b)(1) provides, in pertinent part, that a court may relieve a party from a final judgment for "mistake, inadvertence, surprise, or excusable neglect."[4] Fed.R.Civ.P. 60(b)(1). A motion to vacate a default judgment brought pursuant to this provision "is addressed to the sound discretion of the district court and we will not reverse the denial of such a motion except for abuse of discretion." *S.E.C. v. McNulty,* 137 F.3d 732, 738 (2d Cir.1998) (citations omitted).

When a district court decides a motion to vacate a default judgment pursuant to the provisions of Rule 60(b), the court's determination must be guided by three principal factors: "(1) whether the default was willful, (2) whether the defendant demonstrates the existence of a meritorious defense, and (3) whether, and to what extent, vacating the default will cause the nondefaulting party prejudice." *Id.; see also American Alliance Ins. Co. v. Eagle Ins. Co.,* 92 F.3d 57, 59 (2d Cir.1996). In the appeal at bar, only the second and third factors are implicated because State Street Bank has not challenged the magistrate judge's and the district court's conclusions regarding the absence of a willful default.

A. *Meritorious Defenses and Counterclaims*

"In order to make a sufficient showing of a meritorious defense in connection with a motion to vacate a default judgment, the defendant need not establish his defense conclusively, but he must present evidence of facts that, if proven at trial, would constitute a complete defense." *McNulty,* 137 F.3d at 740 (citation and internal quotation marks omitted); *see also American Alliance Ins. Co.*, 92 F.3d at 61 ("A defense is meritorious if it is good at law so as to give the factfinder some determination to make.") (citation and internal quotation marks omitted).

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[4] Rule 55(c) of the Federal Rules of Civil Procedure expressly allows a court to set aside a default judgment pursuant to Rule 60(b). *See* Fed.R.Civ.P. 55(c).

When the defendants moved to vacate the default judgment, they tried to establish a meritorious defense by articulating, among other things, an array of counterclaims. To date, we have never addressed whether a counterclaim, rather than a response to the substance of a complaint, may constitute a meritorious defense. In the instant appeal, State Street Bank contends that at least one of the counterclaims at issue is unrelated to the substance of the bank's action and should therefore be disqualified from consideration as a meritorious defense. We need not decide that issue here because, even if we were to assume that the counterclaims preserved in these consolidated appeals could be considered as meritorious defenses, they are without merit.

1. *The Meritorious Defense Standard*

The defendants argue that the district court applied an erroneous standard when the court evaluated whether their defense and counterclaims were meritorious.

When the district court set out to appraise whether the defense and counterclaims at issue in this appeal were meritorious, the court did so under an unusual formulation of the governing standard. The court held that "[w]hen, as here, defendants have been given the opportunity to show that a viable defense exists" through the presentation of evidentiary proof in support of their contentions, "they are required to provide some credible indication that if the default judgment is vacated, defendants will be able at trial to establish with finality a meritorious defense which has a reasonable chance of carrying the day." *State Street Bank II*, 246 F.Supp.2d at 242.

The district court's statements appear to suggest that the defendants needed to present sufficient evidence to establish that they had a "reasonable chance of carrying the day." *Id.* Such a test would contravene well settled principles that govern what constitutes a meritorious defense. Whether a defense is meritorious "is measured not by whether there is a likelihood that it will carry the day, but whether the evidence submitted, if proven at trial, would constitute a complete defense." *Enron Oil Corp. v. Diakuhara,* 10 F.3d 90, 98 (2d Cir.1993). This standard applies regardless of whether there has been an evidentiary hearing or an opportunity for discovery. Judging the merit of a defense for the purposes of a motion to vacate a default judgment pursuant to a more rigorous standard would be inappropriate. Default judgments "are generally disfavored and are reserved for rare occasions." *Id.* at 96. As such, the criteria for vacating a default judgment pursuant to Rule 60, including the meritorious defense factor, "should be construed generously." *Id.*

Even if we were to assume that the district court set forth an incorrect principle of law in the abstract, the court ultimately found that the defendants had failed "to establish even the rudimentary elements of a meritorious defense."

State Street Bank II, 246 F.Supp.2d at 242. In other words, the court determined that the defense and the counterclaims in question were wholly without merit. *See, e.g., id.* at 243 ("[The] defendants have failed to present proof even minimally sufficient to show the existence of a meritorious defense."). Given that determination, the district court could not have found that the defense and counterclaims satisfied the proper meritorious defense standard. Indeed, after independently reviewing the record, we agree, for reasons that will become apparent in the discussion that follows, that the defendants failed to establish a meritorious defense and we may affirm the district court's denial of their initial Rule 60(b) motion on that ground. *Cf. Boy Scouts of America v. Wyman,* 335 F.3d 80, 90 (2d Cir.2003) ("[W]e may affirm the judgment of the district court on any ground appearing in the record.").

2. *Implied Covenant of Good Faith and Fair Dealing*

Defendants contend that they put forth a meritorious defense when they asserted a counterclaim against State Street Bank for the breach of an implied covenant of good faith and fair dealing. We disagree.

The facts and allegations pertaining to this counterclaim are relatively straightforward. When Inverraz defaulted on the loans by failing to make the necessary semiannual installment payments required by the Credit Agreements, State Street Bank accelerated Inverraz's debt. Thereafter, Inverraz sought to sell its assets in a purported effort to repay at least a portion of the accelerated debt. As part of this effort, Inverraz entered into negotiations in 2001 with Sociedad Quimica y Minera de Chile (SQM), another Chilean company, regarding the sale of the nitrate and iodine assets of Inverraz's subsidiary, Compaia de Salitre y Yodo Primera Regin S.A. (Cosayach).

Despite these negotiations, Inverraz did not have an unrestricted right to sell assets. Rather, Inverraz's ability to do so was qualified by certain provisions in the Credit Agreements. Each of these agreements included negative covenants that provided, among many other limitations, that neither Inverraz nor its "Restricted Subsidiaries" could sell, transfer, or otherwise dispose of any assets where, *inter alia,* Inverraz had defaulted on the loans enumerated in the agreements. The Credit Agreements defined the term "Restricted Subsidiary" to include "each of the Guarantors" as well as any other entity in certain countries such as Chile of which Inverraz directly or indirectly through other Restricted Subsidiaries owned more than 75% or more of the voting stock or held a 75% financial interest.

Because Inverraz defaulted on the loans, these negative covenants limited the company's rights, as well as the rights of its Restricted Subsidiaries, to sell assets. Indeed, all the parties agree that the defendants could not have sold the aforementioned nitrate and iodine assets to SQM in 2001 unless State Street Bank first consented to such a sale.[5]

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[5] In the proceedings below, the defendants argued that Cosayach was not a Restricted Subsidiary within the meaning of the Credit Agreements. Nonetheless, in their appellate brief, the defendants concede that the asset-sale to SQM could not have gone forward without State Street Bank's prior consent.

After extensive negotiations, SQM apparently agreed in principle to purchase the nitrate and iodine assets for approximately $140 million *if* State Street Bank consented to the sale. This agreement led to a further series of negotiations between the defendants and State Street Bank as the former tried to secure the bank's consent to the sale. According to the defendants, State Street Bank refused to consent to the sale of the assets unless the defendants (a) paid the bank $87 million from the proceeds of the sale, *and* (b) agreed to provide the bank with new collateral and new economic benefits to which the bank would not already have been entitled under the Credit Agreements. On October 5, 2001, SQM notified Inverraz that it would not proceed with the purchase of the assets. The defendants maintain that State Street Bank's refusal to consent to the sale absent its stated conditions led SQM to back away from the transaction.

Defendants contend that the conditions State Street Bank placed on its consent to the sale of the assets to SQM—namely, that the defendants first needed to provide the bank with new collateral and new economic benefits to which the bank was not entitled under the Credit Agreements—were unreasonable. They take the position that, under the law, State Street Bank could only withhold its consent to the sale on reasonable and rational grounds. Because they believe that State Street Bank unreasonably and arbitrarily refused to consent to the sale, they argue that the bank breached a covenant of good faith and fair dealing implied in the Credit Agreements and that this breach constitutes a valid counterclaim for the purposes of their Rule 60(b) motion.

However, despite the defendants' protests to the contrary, New York law does not support their counterclaim.[6]

"Under New York law, a covenant of good faith and fair dealing is implied in all contracts." *1-10 Industry Associates, LLC v. Trim Corp. of America,* 747 N.Y.S.2d 29, 31, 297 A.D.2d 630, 631 (2d Dep't 2002). "This covenant embraces a pledge that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract." *511 West 232nd Owners Corp. v. Jennifer Realty Co.,* 98 N.Y.2d 144, 153, 746 N.Y.S.2d 131, 135, 773 N.E.2d 496, 500 (2002) (citations and internal quotation marks omitted). "Where the contract contemplates the exercise of discretion, this pledge includes a promise not to act arbitrarily or irrationally in exercising that discretion." *Dalton v. Educational Testing Service,* 87 N.Y.2d 384, 389, 639 N.Y.S.2d 977, 979, 663 N.E.2d 289, 291 (1995) (citation omitted).

Nevertheless, the duties imposed by an implied covenant of good faith and fair dealing are "not without limits, and no obligation can be implied that would be inconsistent with other terms of the contractual relationship." *Id.*, 87 N.Y.2d at 389, 639 N.Y.S.2d at 979-80, 663 N.E.2d at 291-92 (citation and quotations marks omitted). Where a contract allows a bank to withhold consent for particular conduct and sets no express restrictions on the bank's right to do so, the bank is not prohibited from unreasonably or arbitrarily withholding such consent. *See Bonady Apartments v. Columbia Banking Fed. Sav. & Loan Ass'n,* 465 N.Y.S.2d 150, 154, 119 Misc.2d 923, 927-28 (N.Y.Sup.Ct.1983), *aff'd as modified in non-relevant part,* 472 N.Y.S.2d 221, 99 A.D.2d 645 (4th Dep't 1984); *see also Teachers Ins. & Annuity Ass'n of America v. Wometco Enterprises,* 833 F.Supp. 344, 349 (S.D.N.Y.1993) ("[I]n the absence of explicit contractual language stating that a party may not unreasonably withhold consent, parties may withhold consent for any reason or no reason, and ... no implied obligation to act in good faith exists to limit that choice."). *Cf. Dress Shirt Sales v. Hotel Martinique Assoc.,* 12 N.Y.2d 339, 342, 239 N.Y.S.2d 660, 662, 190 N.E.2d 10, 11 (1963) ("[U]nless [a] lease provides that [a] lessor's consent shall not be unreasonably withheld," a provision in that lease prohibiting subleasing absent the lessor's consent "permits the lessor to refuse [consent] arbitrarily for any reason or no reason."); *cf. also Caridi v. Markey,* 539 N.Y.S.2d 404, 405, 148 A.D.2d 653, 654 (2nd Dep't 1989) (same).

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[6] Early in the litigation, the district court rejected the defendants' argument that State Street Bank's lawsuit should be dismissed on the grounds of *forum non conveniens. State Street Bank I,* 230 F.Supp.2d at 322-23. In so doing, the court determined that State Street Bank's claims against the defendants were governed by New York law. *Id.* at 322. Subsequently, both the district court and the magistrate judge similarly analyzed the defendants' counterclaims and defenses in accordance with New York law. *See State Street Bank II,* 246 F.Supp.2d at 240-43, 254-61. The defendants and State Street Bank have also done the same, both in the proceedings below and on appeal. As such, we will proceed on the assumption that the defendants' counterclaims as well as their defense are governed by New York law.

Here, the Credit Agreements provided that neither Inverraz nor its Restricted Subsidiaries could sell their assets if Inverraz had defaulted on the loans. As such, all the parties agree on appeal that the defendants could not have sold Cosayach's assets to SQM without State Street Bank's consent. There are no express restrictions in the applicable negative covenants that limit State Street Bank's right to refuse to consent to any such sale in the event of a default. Accordingly, the bank had the right under the Credit Agreements to "withhold consent for any reason or no reason." *Teachers Ins. & Annuity Association of America,* 833 F.Supp. at 349; *see also Bonady Apartments,* 465 N.Y.S.2d at 154, 119 Misc.2d at 927-28.

Moreover, even if an implied covenant of good faith and fair dealing had circumscribed State Street Bank's right to unreasonably or arbitrarily withhold its consent to the sale of Cosayach's assets, the bank's refusal to consent to such a sale was neither unreasonable nor arbitrary. The bank's decision to condition its consent to such a sale on the receipt of additional collateral and economic benefits to which the bank was not entitled under the Credit Agreements was made for a legitimate business purpose. Although State Street Bank might have received $87 million from the proceeds of such a sale, those proceeds fell far short of satisfying the multi-million dollar sum of Inverraz's outstanding accelerated debt. Furthermore, as an unsecured creditor, State Street Bank faced significant uncertainty as to whether it could recover the substantial portion of Inverraz's debt that exceeded the $87 million that might come from the sale of Cosayach's assets to SQM. Under the circumstances, State Street Bank was justified in seeking to protect itself by conditioning its consent to the sale on the receipt of additional collateral and economic benefits. *See Rexnord Holdings v. Bidermann,* 21 F.3d 522, 526- 27 (2d Cir.1994) (holding that the defendant had no viable counterclaim based on any breach of good faith and fair dealing where the defendant had already defaulted on payments due and the plaintiff had refused to extend time to remit payment unless the defendant released the plaintiff from other unrelated obligations); *cf. Bonady Apartments*, 465 N.Y.S.2d at 154, 119 Misc.2d at 928 ("[a] decision by a [bank] to condition its consent to a transfer [of property on an agreement] to pay a higher rate of interest" than the rate set by the original contract was made for a legitimate business purpose exercised in good faith).

Because State Street Bank did not breach a covenant of good faith and fair dealing under New York law, this counterclaim does not constitute a meritorious defense.

3. *Tortious Interference with Business Relations*

Defendants contend that they have articulated a meritorious defense by advancing a counterclaim for tortious interference with business relations. This counterclaim is also based on SQM's decision to break away from its aforementioned negotiations with the defendants regarding the sale of Cosayach's assets. According to the defendants, SQM refused to proceed with the transaction to purchase these assets for $140 million because State Street Bank failed to consent to the sale. The defendants argue that State Street Bank's refusal to consent to the sale unless the defendants provided the bank with additional collateral and economic benefits to which the bank would not have been entitled under the Credit Agreements constituted tortious interference with business relations.

To prevail on a claim for "tortious interference with business relations" under New York law, a party "must prove that (1) it had a business relationship with a third party;[7] (2) the defendant knew of that relationship and intentionally interfered with it; (3) the defendant acted solely out of malice, or used dishonest, unfair, or improper means; and (4) the defendant's interference caused injury to the relationship." *Carvel Corp. v. Noonan,* 350 F.3d 6, 17 (2d Cir.2003); *see also Scutti Enterprises, LLC v. Park Place Entertainment Corp.,* 322 F.3d 211, 215 (2d Cir.2003). On appeal, the defendants vigorously argue that the district court erred in rejecting their tortious interference counterclaim because State Street Bank purportedly employed wrongful means to interfere with the defendants' business relationship with SQM. In other words, they focus on whether the third element of their tortious interference counterclaim has been satisfied.

We need not address the merits of this argument because the defendants have failed adequately to challenge the district court's and the magistrate judge's determinations pertaining to the fourth element of a tortious interference claim, namely the absence of proximate causation. The defendants cannot prevail on their tortious interference counterclaim unless they "demonstrate *both* wrongful means *and* that the wrongful acts were the *proximate cause* of the rejection of the plaintiff's proposed contractual relations." *Pacheco v. United Medical Assoc., P.C.,* 759 N.Y.S.2d 556, 559, 305 A.D.2d 711, 712 (3d Dep't 2003) (citation and internal quotation marks omitted; emphasis added).

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[7] Because we ultimately hold that the defendants' tortious interference claim fails for other reasons, we express no opinion regarding whether the relationship here—consisting of competitors that engaged in failed negotiations over the sale of assets—may constitute "a continuing business or other customary relationship not amounting to a formal contract" sufficient to prove a claim under New York law for tortious interference with business relations. *Scutti Enterprises, LLC v. Park Place Entertainment Corp.,* 322 F.3d 211, 215 (2d Cir.2003) (citation and internal quotation marks omitted).

In the proceedings below, the district court and the magistrate judge determined that the defendants' tortious interference counterclaim did not constitute a meritorious defense for *two* reasons: both because State Street Bank refused to consent to the sale on the basis of legitimate motivations *and* because the bank did not cause the defendants' negotiations with SQM to fall apart. *See State Street Bank II,* 246 F.Supp.2d at 240-41, 255. In their initial appellate brief, the defendants failed altogether to address the proximate cause issue. Rather, the defendants focused exclusively on whether State Street Bank interfered with their business relationship with SQM through wrongful means. When State Street Bank subsequently emphasized the absence of proximate causation in its opposition brief, the defendants responded in a cursory fashion by arguing that State Street Bank "erroneously claims a lack of record evidence of 'proximate cause.' " However, the defendants failed to advance any factual support or legal arguments in favor of that proposition.[8]

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[8] We note that this is not the first occasion on which the defendants have failed to address the issue of proximate cause. When the magistrate judge recommended that the defendants' initial motion to vacate the default judgment should be denied, the defendants submitted objections to the district court. However, although the magistrate judge had determined that the defendants could not prevail on their tortious interference counterclaim because, *inter alia,* they

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When a party fails adequately to present arguments in an appellant's brief, we consider those arguments abandoned. *See Schwapp v. Town of Avon,* 118 F.3d 106, 112 (2d Cir 1997) (refusing to consider several claims on appeal where the appellant failed to make any legal or factual arguments in support thereof). *Cf. Tolbert v. Queens College,* 242 F.3d 58, 75 (2d Cir.2001) (citation and internal quotation marks omitted) ("It is a settled appellate rule that issues adverted to in a perfunctory manner, unaccompanied by some effort at developed argumentation, are deemed waived."); Fed. R.App. P. 28(a)(9)(A) ("The appellant's brief must contain . . . the argument, which must contain . . . [the] appellant's contentions and the reasons for them, with citations to the authorities and parts of the record on which the appellant relies."). Because the defendants have failed to advance any factual or legal arguments with respect to the district court's and magistrate judge's determinations regarding the absence of proximate causation, we conclude that they have, in effect, abandoned any challenge to those findings. As a consequence, they are unable on appeal to demonstrate that they have satisfied the proximate cause element of a tortious interference with business relations

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had failed to establish proximate causation, *see State Street Bank II,* 246 F.Supp.2d at 255, the defendants failed to offer specific objections to that aspect of his report. Instead, they focused for the most part on the merits of their implied covenant of good faith and fair dealing counterclaim and whether State Street Bank would suffer prejudice in the event of vacatur. In most other respects, they merely objected in a cursory fashion to the remaining portions of the magistrate judge's report pertaining to meritorious defenses.

counterclaim and cannot establish a meritorious defense on the basis of such a counterclaim.[9]

4. *Failure to Fulfill Condition Precedent*

In addition to asserting the foregoing counterclaims, the defendants attempt to articulate a meritorious defense by arguing that State Street Bank failed to satisfy the necessary conditions for the initiation of the instant lawsuit. Their arguments are based on certain provisions in several participation agreements.

When State Street Bank loaned Inverraz money in 1994 and 1996, the bank entered into separate agreements with various institutions (the "Participation Agreements"), defined in the agreements as "Participants," pursuant to which the bank sold its interest in the loans to the Participants but retained responsibility for, *inter alia,* collecting on the loans. These Participation Agreements specifically charged State Street Bank with the duty of demanding that Inverraz and the various guarantors perform their obligations under the Credit Agreements and the Guaranty Agreements. However, the Participation Agreements also provided that State Street Bank would "not exercise any . . . rights or powers" that the bank possessed with respect to the loans, absent certain exceptions not relevant here, unless the bank did so "in accordance with the written instruction of the Required Participants." The Participation Agreements defined "Required Participants" as Participants that owned, in the aggregate, more than 50% of the participation interests in the loans.[10]

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[9] Immediately prior to oral argument, the defendants moved to certify certain issues pertaining to their tortious interference counterclaim to the New York Court of Appeals. Those issues implicate the contours of the third element of their tortious interference counterclaim—namely, when a party's alleged interference has been accomplished through "improper" or "wrongful" means. However, because the defendants have not adequately challenged on appeal the district court's and magistrate judge's determinations regarding their failure to satisfy the fourth element of their counterclaim (*i.e.*, proximate cause), we need not address whether these issues should be certified to the New York Court of Appeals. We therefore deny the defendants' motion for certification.

The defendants contend that State Street Bank improperly initiated this lawsuit without complying with the "written instruction" condition because the bank failed to secure the written consent of the "Required Participants" to the commencement of this lawsuit *before* the bank filed this legal action on April 16, 2001. As such, the defendants argue that State Street Bank lacks standing to pursue this lawsuit on the Participants' behalf.

When the defendants advanced this argument in the proceedings below in an effort to present a "meritorious defense," State Street Bank responded by introducing two sets of "Written Direction[s]" during the hearing before the magistrate judge. These directions appear to have been signed by the "Required Participants"[11] and direct State Street Bank

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[10] The 1994 and 1996 Participation Agreements differ somewhat in how they define which Participants qualify as "Required Participants." However, these differences are irrelevant to this appeal.

[11] These "Written Direction[s]" were introduced before the magistrate judge without objection by the defendants. Moreover,

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"to promptly file and serve" the complaint in the lawsuit at bar. The instructions are dated "April 16, 2001;" in other words, they bear the very date on which State Street Bank commenced this legal action. Nevertheless, the defendants maintain that State Street Bank has failed to comply with the condition precedent enumerated in the Participation Agreements because there is no evidence that the Participants signed the foregoing "Written Direction[s]" *before* State Street Bank initiated this lawsuit on April 16, 2001.

The magistrate judge relied on these written instructions, among other things, to reject the defendants' condition precedent defense as a matter of fact. *See State Street Bank II,* 246 F.Supp.2d at 257. The district court found that this factual determination was correct and adopted the magistrate judge's findings of fact. *See id.* at 243.

We review for clear error a district court's findings of fact with respect to the denial of a Rule 60(b) motion to set aside a default judgment. *See Audiovisual Publishers v. Cenco, Inc.,* 580 F.2d 50, 52 (2d Cir.1978). After examining the record, we conclude that the district court's and the magistrate judge's factual determinations regarding the condition precedent defense were not clearly erroneous. Nothing in the record suggests that the Participants failed to sign the written instructions directing State Street Bank to institute this lawsuit before the bank actually initiated the

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the defendants have never argued, either at the evidentiary hearing, before the district court, or on appeal, that these instructions were not signed by all of the Required Participants.

legal action. Accordingly, we agree with the district court and the magistrate judge that the defendants' argument with respect to State Street Bank's supposed failure to comply with the condition precedent set out in the Participation Agreements does not constitute a meritorious defense.[12]

B. *Prejudice*

Defendants argue that the district court erroneously denied their initial motion to vacate the default judgment both because the court incorrectly determined that they had failed to articulate a meritorious defense and because the court mistakenly found that they had failed to demonstrate that State Street Bank would not be prejudiced if the default judgment were vacated. We need not evaluate whether the vacatur of the default judgment would subject State Street Bank to prejudice because we have concluded that the defendants failed to establish a meritorious defense; the absence of such a defense is sufficient to support the district court's denial of the defendants' first Rule 60(b) motion. *See Commercial Bank of Kuwait v. Rafidain Bank,* 15 F.3d 238, 244 (2d Cir.1994). *Cf. Sony Corp. v. Elm State Elec.*, 800 F.2d 317, 320-21 (2d Cir.1986) (affirming the denial of a motion to reopen a default after determining that the defendants failed to demonstrate that they possessed a meritorious defense).

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[12] Given our conclusion regarding this factual determination, we need not address the defendants' argument that they have standing to pursue this defense as third-party beneficiaries of the Participation Agreements.

II. *The Defendants' Second Rule 60(b) Motion*

After the district court denied their initial Rule 60(b) motion to vacate the default judgment, an Inverraz employee found a letter "buried within" his files in December 2002. Once they read this letter, the defendants brought a second motion for relief from the default judgment in February 2003 pursuant to various provisions of Rule 60(b). That new motion also sought to vacate the district court's previous order denying the defendants' prior Rule 60(b) motion.

The newly discovered letter had been written by Inverraz's General Manager in January 1999 and sent to State Street Bank. In this correspondence, the General Manager delineated particular Inverraz subsidiaries which, according to Inverraz, had "become" guarantors or "continue[d] to be" guarantors since the execution of the 1996 Credit Agreement. This copy of the letter appears to have been endorsed by Kelley L. Rumps (Rumps), a former Assistant Vice President at State Street Bank. She countersigned the letter under a heading which read "Received and Agreed By."

Much of the information set out in this copy of the letter had been raised in the instant litigation long before the defendants filed a second Rule 60(b) motion in February 2003. State Street Bank had submitted a copy of the letter when the bank moved the district court to enter a default judgment in October 2001. Furthermore, the defendants submitted the letter as an exhibit when they responded to the bank's opposition brief to their initial motion to vacate the default judgment. Moreover, they successfully persuaded the magistrate judge to admit a copy of the letter as an exhibit during the hearing in May 2002. The defendants tried to rely on this letter as well as a subsequent yet somewhat similar February 2000 letter to articulate a meritorious defense; they argued that such letters corroborated that several of the defendants were not liable as guarantors under the 1996 Credit Agreement. The magistrate judge rejected this argument in his report and recommendation. *See State Street Bank II,* 246 F.Supp.2d at 258-61. The district court agreed with the magistrate judge in this respect and adopted his findings of fact and conclusions of law. *Id.* at 243. On appeal, the defendants have not challenged this aspect of the decision denying their initial Rule 60(b) motion.

The countersignature of a State Street Bank employee, however, sets the copy of the January 1999 letter found in December 2002 apart from the previous copy that had repeatedly been admitted as an exhibit. The previous copy had not been countersigned by anyone from State Street Bank.

The defendants relied on this newly unearthed letter to advance several arguments in their second Rule 60(b) motion. They contended, among other things, that the letter allowed them to establish a meritorious defense and therefore justified the vacatur of the default judgment pursuant to Rule 60(b)(1). The defendants also argued, *inter alia,* that both the district court's order denying their previous Rule 60(b) motion as well as the underlying default judgment should be vacated pursuant to Rule 60(b)(3) because State Street Bank had concealed this critical letter from them over the course of the litigation and thereby perpetrated a fraud against them. In the same vein, they argued that the concealment of this letter also constituted a fraud on the court and thereby merited the vacatur of both the district court's prior order denying their earlier motion and the underlying default judgment pursuant to Rule 60(b). Finally, separate and apart from their allegations pertaining to the letter, the defendants argued that the district court should vacate the default judgment as void pursuant to Rule 60(b)(4) for reasons related to the district court's award of damages. The district court rejected each of these arguments, *see State Street Bank III,* 2003 WL 1907955, at *1- 2, and the defendants now appeal.

A. *Fraud*

Defendants posit that State Street Bank defrauded them and perpetrated a fraud on the court by purportedly withholding a copy of the January 1999 letter *countersigned by Kelly Rumps* during the course of this legal action and by allowing the litigation to proceed on the basis of the copy of the letter signed solely by Inverraz's General Manager. They argue that this alleged fraud merited the vacatur of the default judgment pursuant to Rule 60(b)(3) and Rule 60(b).

The district court rejected the defendants' allegations regarding fraud and found, *inter alia,* that there was no evidence that State Street Bank had ever possessed a version of the letter countersigned by Rumps. *State Street Bank III,* 2003 WL 1907955, at *1. Although the defendants argue that this determination was clearly erroneous, albeit without advancing any evidence whatsoever to support that allegation, we need not address that contention. Even if we were to assume that State Street Bank had concealed the countersigned letter, we would nevertheless affirm the district court's rejection of the defendants' arguments with respect to fraud.

Under Rule 60(b)(3), a district court may relieve a party from a final judgment for "fraud." Fed.R.Civ.P. 60(b)(3). In addition, Rule 60(b) allows a court to set aside a judgment for fraud on the court. *See Campaniello Imports, Ltd. v. Saporiti Italia S.p.A.*, 117 F.3d 655, 661 (2d Cir.1997). However, although the defendants suggest that State Street Bank committed both a fraud and a fraud on the court, we disagree.

As the district court aptly explained, "[i]t is certainly unique to argue that [a] plaintiff concealed a document from [the] defendants that [the] defendants possessed all along in their own files." *State Street Bank III,* 2003 WL 1907955, at *1. To prevail on a Rule 60(b)(3) motion, a movant "must show that the conduct complained of prevented the moving party from fully and fairly presenting his case." *Taylor v. Texgas Corp.*, 831 F.2d 255, 259 (11th Cir.1987) (citations and internal quotation marks omitted); *see also Stridiron v. Stridiron,* 698 F.2d 204, 207 (3d Cir.1983) (same); *Rozier v. Ford Motor Co.,* 573 F.2d 1332, 1339 (5th Cir.1978) (same). These same principles apply when a movant seeks to set aside a judgment on the basis of fraud on the court. *See Davenport Recycling Associates v. C.I.R.,* 220 F.3d 1255, 1262 (11th Cir.2000) ("'Fraud on the court must involve an unconscionable plan or scheme which is designed to improperly influence the court in its decision,' preventing the opposing party 'from fully and fairly presenting his case.'") (quoting *Abatti v. C.I.R.,* 859 F.2d 115, 118 (9th Cir.1988)); *see also Luttrell v. United States,* 644 F.2d 1274, 1276 (9th Cir.1980); *Keys v. Dunbar,* 405 F.2d 955, 957-58 (9th Cir.1969) (per curiam).

Where a movant admits that a letter that the other party supposedly concealed was already present in the movant's files, it "cannot claim that it was prevented from fully presenting its case." *Progressive Casualty Ins. Co. v. Liberty Mutual Ins. Co.*, 1996 WL 524339, at *2 (S.D.N.Y. Sept.13, 1996); *see also Taylor,* 831 F.2d at 259-60 (where the defendant already possessed the information supposedly concealed by the plaintiff, the defendant cannot establish that the plaintiff's failure to reveal that same information prevented it from fully and fairly presenting its case). Here, the defendants concede that they possessed the letter countersigned by Rumps in their own files. As such, they cannot prevail as a matter of law on a Rule 60(b)(3) motion predicated on fraud or a Rule 60(b) motion premised on fraud on the court.

B. *Meritorious Defense*

On appeal, the defendants contend that the district court should have vacated the default judgment pursuant to Rule 60(b)(1) because their new evidence establishes a meritorious defense. They argue that the copy of the January 1999 letter they found buried in their files, which bore Rumps' countersignature, constituted a binding agreement between Rumps' former employer, State Street Bank, and Inverraz and thereby modified the particular guarantors that could be held liable for Inverraz's debt under the 1996 Credit Agreement.

The district court refused to vacate the default judgment on the basis of the countersigned copy of the letter. The court found the newly discovered correspondence to be "immaterial." *State Street Bank III,* 2003 WL 1907955, at *2 n. 3. The court arrived at this conclusion after explaining that the "recently unearthed document would have had no bearing whatsoever on the court's determination to uphold the default judgment." *Id.* at *1.

We agree with the district court that the 1999 correspondence signed by Rumps was immaterial. We therefore affirm the court's refusal to vacate the default judgment on the basis of that letter. We also affirm the district court's denial of the second Rule 60(b)(1) motion on the additional ground that the defendants failed to defend against the default judgment with sufficient diligence to merit its vacatur.

As we mentioned earlier, Rule 60(b)(1) permits a court to vacate a judgment on the grounds of "excusable neglect." Fed.R.Civ.P. 60(b)(1). However, where a party fails to act with diligence, he will be unable to demonstrate that his conduct constituted "excusable neglect." *See Martella v. Marine Cooks & Stewards Union,* 448 F.2d 729, 730 (9th Cir.1971) (per curiam); *see also* 11 Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 2858, at 288-89 (2d ed. 1995) ("Insufficient showings for relief [under Rule 60(b)(1)] . . . include when the party or attorney did not act diligently"); 12 James Wm. Moore *et al., Moore's Federal Practice* § 60.41[1][c][ii], at 60-90 (3d ed. 1997) ("Courts repeatedly deny relief [pursuant to 60(b)(1)] when they find that the facts and circumstance[s] demonstrate a lack of diligence in pursuing or defending litigation."). *Cf. Ramseur v. Beyer,* 921 F.2d 504, 506 (3d Cir.1990) (recognizing that a court must be satisfied that attorneys acted with substantial diligence before finding "excusable neglect"). Hence, when a party demonstrates a lack of diligence in defending a lawsuit, a court need not set aside a default judgment. *See Florida Physician's Ins. Co. v. Ehlers,* 8 F.3d 780, 784 (11th Cir.1993) (per curiam).

Here, the defendants asserted from the outset that a number of them were not liable as guarantors under the 1996 Credit Agreement. They pressed this legal argument before the magistrate judge in May 2002 and even sought to introduce the January 1999 letter in support thereof, although their copy of the letter lacked Rumps' countersignature. When they brought their second Rule 60(b) motion in February 2003 on the basis of the countersigned copy of the letter that they unearthed in their own files, the defendants offered no explanation regarding why they could not, with diligence, have found that same exhibit in their inventory during the course of their earlier efforts to defend against the default judgment through the articulation of meritorious defenses. In essence, although they tied up significant judicial resources by advancing a host of defenses and counterclaims as part of an extensive effort to vacate the default judgment, the defendants subsequently tried to get a second bite at the meritorious defense apple by submitting new evidence they apparently possessed all along during the earlier proceedings when the district court and the magistrate judge were specifically reviewing the legal arguments implicated by the new evidence. Under these circumstances, the defendants failed diligently to defend against the default judgment at the appropriate time on the basis of this evidence and the district court properly denied their second Rule 60(b)(1) motion given the absence of excusable neglect.

If anything, the nature of the arguments raised by the defendants with respect to the newly found letter indicate that their second Rule 60(b) motion, although supposedly predicated in part on Rule 60(b)(1), appears more properly to be governed by Rule 60(b)(2). Where a claim "sounds very much like a claim regarding newly discovered evidence," the claim is "controlled by 60(b)(2)" and should not be labeled as if brought under a different provision of Rule 60(b). *Kalamazoo River Study Group v. Rockwell Int'l Corp.*, 355 F.3d 574, 588 (6th Cir.2004). Here, the facts explain why the defendants apparently failed to label their second Rule 60(b)(1) motion as one properly brought in accordance with Rule 60(b)(2). Under that provision, the problems associated with the "newly" found letter are patently clear. To prevail on a motion for relief pursuant to Rule 60(b)(2), a movant must demonstrate that he was justifiably ignorant of the newly discovered evidence despite due diligence. *See United States v. Int'l Brotherhood of Teamsters,* 247 F.3d 370, 392 (2d Cir.2001). As our previous recitation of the facts underscores, the defendants have offered no explanation for why they failed to discover the countersigned letter in their own files before December 2002 and to introduce such evidence at the particular time when the district court and magistrate judge were considering whether certain defendants were liable under the 1996 Credit Agreement. In short, they have failed to demonstrate that they were justifiably ignorant of the letter in their files despite due diligence.

C. *Rule 60(b)(4) Motion*

Defendants argue that the district court erred by refusing to vacate the default judgment as void pursuant to Rule 60(b)(4). According to the defendants, the judgment is void for several reasons. First, the defendants fault the district court for awarding damages for "liquidated amounts" despite the prayer in State Street Bank's complaint seeking "generalized relief." In addition, the defendants contend that the judgment is void because the court imposed damages in the default judgment without conducting an inquest to ascertain the proper amount of damages against each defendant. They also raise questions about the validity of the judgment where the court awarded damages against the defendants jointly and severally for the entire accelerated debt due pursuant to the Credit Agreements where the Guaranty Agreements required particular entities to pay for only a specific percentage of that debt.

Under Rule 60(b)(4), a district court may relieve a party from a final judgment if "the judgment is void." Fed.R.Civ.P. 60(b)(4). Whereas we generally review motions pursuant to the provisions of Rule 60(b) for abuse of discretion, we review *de novo* a district court's denial of a Rule 60(b)(4) motion. *Central Vermont Public Service Corp. v. Herbert,* 341 F.3d 186, 189 (2d Cir.2003). "Under Rule 60(b)(4) a deferential standard of review is not appropriate because if the underlying judgment is void, it is a *per se* abuse of discretion for a district court to deny a movant's motion to vacate the judgment under Rule 60(b)(4)." *Id.* (citations and internal quotation marks omitted).

A default judgment may be considered void if the judgment has been entered "in a manner inconsistent with due process of law." *Fustok v. ContiCommodity Serv.*, 873 F.2d 38, 39 (2d Cir.1989) (citations and internal quotation marks omitted). However, we need not decide whether the default judgment is void. Even if we were to assume that the default judgment did violate due process, and was void as a result, we would nonetheless affirm the district court's denial of the defendants' Rule 60(b)(4) motion because their motion was untimely.

On appeal, the defendants fail to acknowledge that the district court denied their Rule 60(b)(4) motion for *two* independent reasons. On the one hand, the district court found the defendants' arguments regarding the validity of the judgment to be "meritless." *State Street Bank III,* 2003 WL 1907955, at *2. In this respect, the court explained that it had "not merely award[ed] the damages prayed for by [State Street Bank] without investigation." *Id.* Rather, the court held that "its determination of damages [rested] on the affidavit of Fred Epstein, who detailed how damages were calculated in accordance with the [Credit Agreements and Guaranty] [A]greements at issue." *Id.* As such, the court found that "no violation [of 60(b)(4)] occurred here."[13] *Id.*

The district court *also* denied the defendants' Rule 60(b)(4) motion because the defendants failed to raise their voidness argument in their prior Rule 60(b) motion even though they "had ample opportunity to do so." *Id.* In the appeal at bar, State Street Bank argues that the district court properly denied the defendants' Rule 60(b)(4) motion as untimely pursuant to this rationale and we agree.

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[13] We express no opinion, in light of our conclusion that the defendants' Rule 60(b)(4) motion was untimely, regarding whether a challenge to a district court's determination of damages in a default judgment is properly brought through the vehicle of a Rule 60(b)(4) motion rather than through a direct appeal.

As we explained several years ago,

> a Rule 60(b)(4) motion must be made "within a reasonable time" after entry of the judgment. Courts have been exceedingly lenient in defining the term "reasonable time," with regard to voidness challenges. In fact, it has been oft-stated that, for all intents and purposes, a motion to vacate a default judgment as void "may be made at any time."

Beller & Keller v. Tyler, 120 F.3d 21, 24 (2d Cir.1997) (citations omitted). Nevertheless, where a party has previously filed a motion to vacate a default judgment that failed to raise a voidness argument and subsequently advances such an argument in a Rule 60(b)(4) motion more than a year after the entry of the default judgment, the Rule 60(b)(4) motion should be denied as untimely. *See id.* at 22-24; *see also Planet Corp. v. Sullivan,* 702 F.2d 123, 125-26 (7th Cir.1983).

Here, the default judgment was entered on the docket on December 4, 2001. Not long thereafter, the defendants brought their first motion to vacate the default judgment. Although they litigated that motion for many months, the defendants failed to argue that the default judgment was void for any reason related to the district court's award of damages. Instead, the defendants advanced such an argument for the first time in the second Rule 60(b) motion they filed in February 2003. Under these circumstances, we conclude that the district court properly denied their Rule 60(b)(4) motion as untimely.[14]

D. *Sanctions*

State Street Bank asks us to sanction the defendants as well as their counsel for re-litigating many of the unsuccessful arguments they articulated in their Rule 60(b) motions in the proceedings below. The bank suggests that we should impose sanctions pursuant to either Rule 38 of the Federal Rules of Appellate Procedure, 28 U.S.C. § 1927, or our inherent authority to do so.

We begin by noting that sanctions would not be justified under Rule 38. That provision allows a court of appeals to award "just damages and single or double costs to the appellee" if the court has determined that an appeal is "frivolous." Fed. R.App. P. 38. However, such sanctions may only be imposed "'after a separately filed motion or notice from the court.'" *Great American Ins. Co. v. M/V Handy Laker,* 348 F.3d 352, 354 (2d Cir.2003) (per curiam) (quoting Fed. R.App. P. 38). "Since neither of those measures has been taken in this case," we refuse to award sanctions to State Street Bank pursuant to Rule 38. *Id.*

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[14] We end our discussion of the two Rule 60(b) motions at issue in this appeal by noting that, in the final footnote of their initial appellate brief, the defendants argue that if the default judgment is not vacated on the various specific grounds enumerated in their brief, that judgment should, in the alternative, be vacated pursuant to Rule 60(b)(6) "in the interests of due-process, justice and international comity." They do not expand on this contention beyond that statement. An argument "is not sufficiently presented for appeal if it is conclusorily asserted only in a footnote." *Tolbert,* 242 F.3d at 76. Accordingly, we do not address the defendants' Rule 60(b)(6) argument on appeal.

We also conclude that sanctions would not be appropriate under 28 U.S.C. § 1927.[15] Section 1927 authorizes the imposition of sanctions only "when there is a finding of conduct constituting or akin to bad faith." *Sakon v. Andreo,* 119 F.3d 109, 114 (2d Cir.1997). "We have held that an award under [section] 1927 is proper when the attorney's actions are so completely without merit as to require the conclusion that they must have been undertaken for some improper purpose such as delay." *In re 60 East 80th Street Equities,* 218 F.3d 109, 115 (2d Cir.2000) (citations and internal quotation marks omitted). Although certain actions taken by defendants' counsel approach the borders of this standard, particularly with respect to his arguments on appeal pertaining to fraud and fraud on the court, we are ultimately unpersuaded that he articulated various arguments in these consolidated appellate proceedings in bad faith. Hence, sanctions would not be justified under 28 U.S.C. § 1927. Under these circumstances, we also decline to sanction the defendants or their counsel in accordance with our inherent authority to do so.[16] *See Sakon,* 119 F.3d at 114.

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[15] Section 1927 provides:

> Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorney's fees reasonably incurred because of such conduct.

28 U.S.C. § 1927.

CONCLUSION

For the foregoing reasons, we affirm the district court's denials of the motions the defendants brought pursuant to the provisions of Rule 60(b). We also deny the defendants' motion to certify certain issues pertaining to the merits of their tortious interference counterclaim to the New York Court of Appeals.

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[16] Nothing in our holding regarding sanctions should be read to prohibit State Street Bank, as the prevailing party, from seeking costs in accordance with Rule 39 of the Federal Rules of Appellate Procedure. *See* Fed. R.App. P. 39 (providing that, "if a judgment is affirmed, costs are taxed against the appellant").

APPENDIX B — OPINION OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED APRIL 17, 2003

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

No. 01 Civ. 3201(RLC)

STATE STREET BANK AND TRUST COMPANY,

Plaintiff,

v.

INVERSIONES ERRAZURIZ, LIMITADA (f/k/a Inversiones Errazuriz S.A.), SUPERMERCADOS UNIMARC S.A. (f/k/a COMMERCIAL E INMOBILIARIA UNIMARC S.A.), PESQUERA NACIONAL S.A., UNIMARC ABASTECIMIENTOS S.A., CIDEF S.A., SALMONES UNIMARC S.A., INDUSTRIA FORESTAL REGIONAL S.A., CIDEF ARGENTINA S.A., CORPORACIN DE INVERSIONES Y DESARROLLO FINANCIERO CIDEF S.A., and SOCIEDAD CONTRACTUAL MINERA COMPAIA DE SALITRE Y YODO PRIMERA REGIN (f/k/a COMPAIA DE SALITRE Y YODO PRIMERA PRIMERA REGIN S.A.),

Defendants.

OPINION

ROBERT L. CARTER, District Judge

On November 5, 2002, the court denied defendants' motion to vacate the default judgment entered against them, concluding that defendants' seven asserted counterclaim defenses lacked merit and that defendants failed to establish that vacation of the default judgment would not result in prejudice to plaintiff. Defendants now move for relief from the judgment, pursuant to Rule 60(b), F.R. Civ. P.

BACKGROUND

The facts relevant to this motion are as follows. Sometime in late December, 2002, approximately one-and-a-half months after the court's entry of the default judgment, defendants discovered in their files a 1999 letter signed by agents of plaintiff and defendants. Another version of the document, signed by defendants' agent but not signed by plaintiff's agent, was already part of the record in this case. Defendants claim that the countersigned version of the 1999 letter establishes a meritorious defense to their liability. Defendants further claim that plaintiff and plaintiff's counsel withheld and concealed this version of the letter, thereby committing a "fraud on the court."

DISCUSSION

I. Rule 60(b)

Under Rule 60(b), "the court may relieve a party or a party's legal representative from a final judgment, order, or proceeding for . . . (3) fraud . . . , misrepresentation, or other misconduct of an adverse party . . . or . . . set aside a judgment for fraud upon the court." In this Circuit, it is well established that a Rule 60(b) motion cannot be granted without clear and convincing evidence. *Madonna v. United States,* 878 F.2d 62, 64-65 (2d Cir.1989). It is also clear that unless the allegedly concealed information was material to the determination made by the court, relief under Rule 60(b) will not lie. *Fleming v. New York Univ.,* 865 F.2d 478, 484 (2d Cir.1989).

Defendants' purported "evidence" does not even approach that which would warrant relief under the fraud provisions of 60(b), for two reasons. First, there is simply no evidence that plaintiff or its counsel committed fraud. Defendants assert, over and over again, that plaintiff, through its attorneys, concealed and withheld the 1999 letter. It is certainly unique to argue that plaintiff concealed a document from defendants that defendants possessed all along in their own files. Not surprisingly, defendants fail to provide clear and convincing evidence in support of their claim. There is no evidence that plaintiff is, or was at any time, in possession of a countersigned version of the letter. Nor is there evidence that plaintiff or its counsel somehow became aware of the document in defendants' files without defendants' knowledge, and then concealed the existence of the document from the defendants or the court.

Second, it is clear that this recently unearthed document would have had no bearing whatsoever on the court's determination to uphold the default judgment. In accordance with the terms of the parties' 1996 Credit Agreement, the purpose of the 1999 letter was to give written notice of the Guarantors' Attributable Liability within five business days of a Liability Calculation Date. What defendants seem to inexplicably ignore is that in February, 2000, a written notice was issued that superseded the 1999 letter, as it provided notice of each Guarantor's Attributable Liability as of January 1, 2000.[1]

Furthermore, the 2000 letter of notice, identical in purpose and essentially identical in form to the 1999 letter, was considered in Judge Maas's Report and Recommendation ("R & R"). *See* R & R at 33-36. Judge Maas concluded that the 2000 letter was irrelevant to the question of liability, a conclusion that was adopted by the court upon *de novo* review in its November 5, 2002 opinion.[2] In finding Judge Maas's determinations to be correct both on the facts and the law, the court rejected the very argument with respect to the 2000 letter that defendants now assert in regard to the 1999 letter. In light of the court's previous disposition of this matter, it is difficult to comprehend how defendants could believe that they have a colorable claim for relief from the judgment based on the 1999 letter.[3]

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[1] Defendants seemed to recognize that the 2000 letter superseded the 1999 letter in the hearing before Judge Maas. During the hearing, they focused on the 2000 letter of notice, despite possessing a non-countersigned version of the 1999 letter. The 1999 letter and a May 15, 1998 letter were admitted in evidence, accompanied only by defense counsel's comment that these were "two additional prior statements." (Tr. at 175.)

[2] Although *de novo* review wasn't required, the court nevertheless afforded this review "to provide double assurance that the final disposition is a fair one." *State Street Bank and Trust Co. v. Inversiones Errazuriz Lta., et al,* 01 Civ. 3201, 2002 WL 31478204, at *7 (S.D.N.Y. Nov.5, 2002) (Carter, J.).

Defendants make two other equally baseless arguments for relief under 60(b). First, they argue for relief under 60(b)(6), pursuant to which relief may be granted for "any other reason justifying relief from the operation of the judgment." Rule 60(b)(6) is properly invoked only when the asserted grounds for relief are not recognized in clauses (1)-(5) of the Rule. *Nemaizer v. Baker,* 793 F.2d 58, 63 (2d Cir.1986). Here, the alleged concealment falls within 60(b)(3) and the "fraud upon the court" clauses. Accordingly, defendants' argument under 60(b)(6) is rejected.

Finally, defendants argue that the default judgment should be deemed void and relief granted pursuant to 60(b)(4) because the court failed to conduct an inquest concerning the damages sought in the complaint prior to entering judgment. Defendants did not raise this argument at any point during the proceedings on the motion to vacate the judgment, although they had ample opportunity to do so. This failure alone is fatal to defendants' claim. *Id.* at 64-65.

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[3] Defendants submitted a letter application requesting discovery into the circumstances of the alleged fraud. As the court has determined that the 1999 letter is immaterial, any further discovery would be a waste of time and resources. Defendants' application is denied.

Also, it did not escape the court's notice that, in arguing that this document is material, defendants misleadingly quoted a separate and unrelated portion of Judge Maas's R & R.

The argument is meritless in any case. The court did not merely award the damages prayed for by plaintiff without investigation. Rather, the court rested its determination of damages on the affidavit of Fred Epstein, who detailed how damages were calculated in accordance with the agreements at issue.[4] Hence, even if the failure to conduct an inquest into damages could constitute a violation of 60(b)(4), which is not at all apparent, no violation occurred here.

II. Sanctions

Plaintiff urges the court to impose sanctions, pursuant to Rule 11, F.R. Civ. P. I am mindful of plaintiff's (and plaintiff's counsel's) frustration in dealing with this motion, and am also mindful of the fact that defendants' submissions probably amount to sanctionable conduct. This is not the first time that I have been forced to address defense counsel's improprieties, specifically Mr. Wolk's "constant repetition of untruths" in advancement of baseless claims. Nonetheless, I choose not to impose the drastic remedy of sanctions. Instead, I urge defense counsel *in the strongest possible terms* to use the utmost care when treading the outer bounds of zealous advocacy in future proceedings.

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[4] Defendants do not point to any error in these calculations.

CONCLUSION

Defendants' Rule 60(b) motion is denied in its entirety. The court declines to impose sanctions under Rule 11, F.R. Civ. P.

IT IS SO ORDERED.

Dated: New York, New York
April 17, 2003

s/ Robert L. Carter
ROBERT L. CARTER
U.S.D.J.

APPENDIX C — OPINION OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED NOVEMBER 5, 2002

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

No. 01 Civ. 3201(RLC)

STATE STREET BANK AND TRUST COMPANY,

Plaintiff,

- against -

INVERSIONES ERRAZURIZ LIMITADA (f/k/a INVERSIONES ERRAZURIZ S.A.), et al.,

Defendants.

OPINION

ROBERT L. CARTER, District Judge.

This litigation concerns the propriety of a default judgment issued against defendants on November 30, 2001, for $140 million. Defendants filed a motion to vacate the default on December 19, 2001, asserting that the default was not willful, along with some nine allegedly meritorious counterclaim defenses and a contention that the vacatur of the default judgment would not prejudice the plaintiff. On February 4, 2002, the court filed an opinion, with which familiarity is assumed, No. 01 Civ. 3201, 2002 WL 181697, dismissing two of the claimed counterclaim defenses and referring the issues of willfulness of the default, the meritoriousness of the seven remaining counterclaim defenses and whether vacatur would cause prejudice to plaintiff to Magistrate Judge Frank Maas for further inquiry. On August 15, 2002, the magistrate judge filed his Report and Recommendation ("R & R") in which he found (at 12-20) that defendants had not willfully defaulted, that their counterclaim defenses lacked merit (*id.* at 20-39), and that to vacate the default judgment would prejudice plaintiff (*id.* at 39-43).

Defendants filed timely objections to the R & R on September 13, 2002, having been granted by stipulation and order an enlargement of time to file objections beyond the normal ten day deadline. Defendants

> pursuant to the legal reasons set forth below, (a) object to these portions of the Magistrate [sic] Report, (b) they maintain that the evidence adduced at the Hearing shows the existence of a meritorious defense or counterclaim in this case, (c) they maintain that the evidence adduced at the Hearing shows that there would not be an impermissible level of prejudice to the Plaintiff if the default judgment were vacated and (d) they respectfully request that Judge Carter determine, as a matter of law, that they have satisfied their burden, under FRCP 60(b), of showing the existence of a meritorious defense or counterclaim, and that vacatur of the default judgment would not result in an impermissible level of prejudice to the Plaintiff herein.

(Defs.' Obj. at 3-4.) Defendants also objected to pages 20-29 of the R & R that they "have not shown the existence of a meritorious defense" and to pages 39-43 of the R & R that they have not shown that plaintiff would not be prejudiced if the motion to vacate the default judgment was granted. (*Id.*)

Plaintiff in its response to defendants' objections contended that except for their objection to the finding on the defense of the implied obligation of good faith and fair dealing, the objections to the remaining lack of meritorious defense and prejudice to plaintiff findings are not sufficiently specific and should be disregarded by the court. (Pl.'s Reply Mem. at 23-24.) In reply defendants repeat in summary their prior arguments. Neither side contests the R & R finding on the question of willfulness.

The court has reviewed: (1) the transcripts of April 3, 2002, in which the dates and contour of the forthcoming hearing before the magistrate judge was agreed to; (2) the May 23 and May 24, 2002 transcripts of the hearing itself; (3) all the exhibits introduced at the hearing, the R & R, the defendants' objections and letter reply to plaintiff's response, and plaintiff's response to defendants' objections.

The depositions of Messers. Foncillas or Trujillo, two lawyers in the Gibson, Dunn & Crutcher firm ("Gibson Dunn") were not read, but their testimony has no relevance to the issues under present consideration since at best it would concern the question of willfulness to which neither side objects or the reason Gibson Dunn refused to represent defendants in this proceeding, matters irrelevant to the issues presently under court consideration. Accordingly, review of the materials set forth above sufficed as to the merits of the counterclaim defenses and the issue of prejudice to meet the de novo review requirements of Rule 72(b), F.R. Civ. P. *See United States v. Raddatz,* 447 U.S. 667, 674 (1980).

Initial Proceedings in the District Court

On April 16, 2001, plaintiff filed suit against defendants in this court seeking to recover in excess of 100 million dollars owed pursuant to two credit agreements executed in 1994 and 1996 respectively. (Compl.¶ 1.) Defendants filed no answer, but for several months the parties engaged in settlement discussions. In late June, 2001, the parties entered a stipulation extending the time to answer, in which defendants acknowledged service of process and the personal jurisdiction of the court. The stipulated extended time to answer passed, but the effort to reach an agreeable solution continued. On September 28, 2001, plaintiff, however, filed a motion for default judgment. The deadline for defendants to file responsive pleading to the motion passed with no word from defendants. On November 30, 2001, the court granted plaintiff's motion and entered default judgment for roughly 140 million dollars against defendants.

Present counsel for defendants, early in December, 2001, advised the court that he now represented defendants, and against the court's advice that the proper response was a motion to vacate the default judgment filed an order to show cause. The court refused to accept that pleading and finally on December 19, 2001, defendants filed a motion to vacate the default judgment.

Defendants contended that the case is within the purview of F.R. Civ. P. 60(b), which provides that a default judgment may be set aside for reason of "mistake, inadvertence, surprise, or excusable neglect." In assessing the existence of excusable neglect, the court must determine: "(1) whether the default was willful; (2) whether the defendant has a meritorious defense; and (3) the level of prejudice that may occur to the non defaulting party if relief is granted." *Am. Alliance Ins. Co., Ltd. v. Eagle Ins. Co.,* 92 F.3d 57, 59 (2d Cir.1996) (*quoting Davis v. Musler,* 713 F.2d 907, 915 (2d Cir.1983)).

Defendants contended that their default was not willful but was based on a good faith belief that Gibson Dunn, the firm that had handled their legal affairs in the United States for some 25 years would represent them in this litigation. They asserted that the plaintiff's case should be dismissed on the grounds of forum non conveniens, and in addition alleged the following eight counterclaim defenses as part of their meritorious defense showing: (1) that plaintiff has impermissibly interfered with defendants' property prior to court judgment on the merits of their dispute (Defs.' Mem. at 107-11); (2) that plaintiff has engaged in activity constituting a breach of its implied duty of good faith and fair dealing under the credit and guaranty agreements (*id.* at 112); (3) that plaintiff has engaged in knowing, intentional and/or tortious interference with defendants' contractual relations, business operations and prospective economic advantage (*id.* at 113-16); (4) that plaintiff made fraudulent and/or negligent misrepresentations regarding their rights under the credit and guaranty agreements (*id.* at 116-17); (5) that plaintiff has breached its fiduciary duty required under the credit and guaranty agreements (*id.* at 118-20); (6) that plaintiff's case is defective in that it violates the conditions for bringing suit set forth in the credit and guaranty agreements (*id.* at 75); (7) that the default judgment is defective because it contains a declaratory ruling that restricts the assets of a non party to this lawsuit (Defs.' Reply Mem. at 5-9); and (8) that the default judgment is also defective in awarding damages against four defendants who are not guarantors under either the 1994 or 1996 credit agreements and against two defendants who are not guarantors under the 1996 credit agreement (*id.* at 10).

In its February 4, 2002 opinion at *4-8, the court dismissed defendants' forum non conveniens claim and the first counterclaim defense, i.e., that plaintiff has impermissibly interfered with defendants' property prior to a court judgment. *See State Street Bank and Trust Co. v. Inversiones Errazuriz Limitada,* 230 F.Supp.2d 313 (S.D.N.Y.2002) (Carter, J.). The issue of willfulness, the seven remaining counterclaim defenses, and the question of the prejudice to plaintiff if the motion to vacate the default judgment was granted were referred to Magistrate Judge Frank Maas for further inquiry. Magistrate Judge Maas was to decide "whether the defendants possess a substantial meritorious defense, or whether the claims made in defendants' papers . . . are just 'spurious.'" *Id.* at *8 (citing *Ferraro v. Kuznetz,* 131 F.R.D. 414, 420 (S.D.N.Y.1990) (Patterson, J.)). Referral of these issues to Magistrate Judge Maas was to afford defendants the opportunity to present the compelling evidence they claimed to possess showing that the default was not willful, the lack of prejudice to plaintiff if defendants prevail, and the viability of their seven counterclaim defenses establishing their meritorious defense, thus making it appropriate for the court to vacate the default judgment.

Defendants were ordered to confine their evidentiary submissions concerning the merits of their defenses to the seven counterclaim defenses specified in the court's opinion. "The purpose of [the hearing before Magistrate Judge Maas] is not to give defendants an opportunity to comb the case law for still more legal defenses to interpose in this case—the time for that endeavor has passed." *Id.* at *8 n. 16. In summary the court stated "defendants have not, as yet, presented sufficient evidence on the issues of willfulness, meritorious defense, and prejudice to justify vacating the default judgment. What they have done is raise a number of questions that warrant further briefing and factual inquiry. Accordingly, the court refers them to Magistrate Judge Frank Maas for report and recommendation." *Id.* at *9.

Proceedings Before The Magistrate Judge

Magistrate Judge Maas held a conference on April 3, 2002, with the parties and Mitchell A. Karlan and Richard J. Davis, attorneys from the Gibson Dunn firm. At the conference, the deposition of each of the attorneys of Gibson Dunn whom the parties wanted to depose was agreed to, and agreement was reached as well for the production of all documents from the firm deemed relevant by the parties. The parties agreed to submit supplemental responses to various interrogatories to satisfy the other side that the information given was full and complete.

A forthcoming evidentiary hearing was set at which point Magistrate Judge Maas inquired: "the sum of what I am going to hear is what will be set forth in your supplemental responses to the interrogatory and anything else you may garner from the three depositions that are to be taken and the Reilly deposition that was already taken, correct?"

> Mr. M. Wolk: "I mean, that sounds fair to me and that's what I'll try to do."
>
> The court: "So Mr. Moödhe and I can both be comfortable that when and if there is a hearing, none of your clients will be coming in and testifying about something that either hasn't been testified to previously by Gibson Dunn lawyers or hasn't been set forth in your interrogatory response as to the relevant issue of what promises or commitments were made."
>
> Mr. M. Wolk: "That is fine."
>
> The court: "O.K. I assume that works for you, Mr. Moodhe."
>
> Mr. Moodhe: "Yes, your Honor, it does."

(Tr. at 36-37.)[1]

A two day evidentiary hearing was held on May 23-24, 2002. At the hearing was Senator Francisco Javier

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[1] Tr. refers to transcript of the April 3, 2002 hearing.

Errazuriz—Talavera, head of the family having a controlling interest in Inversiones Errazuriz Limitada ("Inverraz") as well as in all the other defendants, Conor D. Reilly, a partner in Gibson Dunn, Jorge Sims, chairman of the Board of Inverraz, Francisco Javier Errazuriz-Ovalle, the Senator's son and general manager of Inverraz and Blake T. Franklin, a partner in Gibson Dunn who had handled or overseen the handling of various legal activities for the Senator and his many business operations for roughly 25 years.

Thereafter the parties filed their briefs. After review of the testimony adduced at the hearing and the parties' extensive briefing, Magistrate Judge Maas on August 15, 2002, filed his R & R holding that defendants' motion to vacate the default should be denied.

He made detailed and specific findings of fact and conclusions of law as to each issue submitted to him for inquiry. He concluded, after a thorough review of the facts and circumstances surrounding defendants' 25 year relationship with Gibson Dunn, that defendants' delay in responding to the instant action could not "be characterized as 'wilful,' " and that therefore defendants "had met their burden with respect to this first element of the showing necessary to vacate the default judgment." (R & R at 20.)

Magistrate Judge Maas concluded that each of defendants' seven counterclaim defenses submitted to him for further inquiry (breach of obligation of good faith and fair dealing, tortious interference, fraudulent and/or negligent misrepresentations, breach of fiduciary duty under the credit and guaranty agreements, institution of suit violates conditions in the agreements for bringing suit, default judgment defective in restricting assets of a company not involved in the case, and default judgment defective in awarding damages against defendants not guarantors and therefore that defendants had failed to establish a meritorious defense) (R & R at 20-39) lacked merit. Although that alone required that the motion to vacate the default judgment be denied, *see, e.g., Sony Corp. v. Elm State Electronics, Inc.*, 800 F.2d 317 (2d. Cir.1986); *National Union Fire Ins. Co. v. Allard,* No. 87 Civ. 5368, 1989 WL 71168, at *1 (S.D.N.Y.1989) (Stanton, J.), because the issue of prejudice had also been referred to him, he undertook to decide that question as well.

The magistrate judge at defendants' request had, prior to the evidentiary hearing, required plaintiff to detail in an interrogatory answer how it would be prejudiced if the default judgment were to be vacated. Plaintiff identified "a lengthy series of allegedly improper transactions involving Cosayach and its subsidiaries" (R & R at 40) to show that it would be prejudiced by vacatur of the default judgment. (*See* Defs.' Exh. O.) At the evidentiary hearing Sims had agreed that each of the transactions had occurred after Inverraz had defaulted on its loan payments. (Tr. at 232.) Sims' testimony that the transactions did not violate the credit agreement notwithstanding (*id.* at 228), Magistrate Judge Maas concluded that each of the post-default transactions violated the terms of the credit agreements (R & R at 40) since he found that Cosayach was a restricted subsidiary and could not be sold while Inverraz was in default, but that defendants "continue to ignore the plain language of their agreements, as well as the negative covenants designed to protect State

Street's investment, there obviously is a substantial risk that such impermissible transactions will continue in the future if the default judgment is vacated". (R & R at 43.) He concluded that defendants had not met their burden of showing a lack of prejudice. (*Id.*)

Defendants' Objections and Plaintiff's Response

Defendants maintain that they have established "at least three meritorious defenses or counterclaims which, if established at trial, would be a complete defense and/or offset to plaintiff's claims: (a) conduct by the Plaintiff which . . . would constitute a breach of Plaintiff's implied obligation of good faith and fair dealing in the performance and/or enforcement of the subject loan and guaranty contracts entered into by the parties [this is a complete defense to Plaintiff's claims], (b) conduct by Plaintiff which . . . would constitute a tortious interference with the Chilean Defendants' contractual relations, business expectancies and prospective economic advantage in Chile [this is a complete, related counterclaim to the Plaintiff's claims] and (c) conduct by the Plaintiff which . . . would constitute a failure to fulfill a required condition precedent to the institution of this lawsuit in this Court [this is a complete defense to Plaintiff's claims]." (Defs.' Obj. at 4.)

The first objection as more fully articulated appears to be a counterclaim defense not heretofore argued before the magistrate judge or the district court to the effect that plaintiff had violated its implied covenant of good faith and fair dealing in seeking to extract from defendants collateral and other economic benefits as the price for its agreeing to approve a deal with SQM pursuant to which defendants would receive $140 million, $87 million of which would go to plaintiff and reduce defendants' indebtedness to plaintiff. (*Id.* at 11-40.)

The second objection is a repetition of their failed argument before the magistrate judge that they had a meritorious counterclaim defense to the effect that plaintiff had been guilty of tortious interference with Inverraz's negotiations for the sale of the nitrate and iodine assets of Cosayach to SQM. The third objection was also a contention rejected by the magistrate judge to the effect that the suit is defective in that plaintiff failed to fulfill a required condition precedent prior to instituting this litigation.

For the substance of these two objections, the court is referred "to their prior submissions" before the district court and the magistrate judge. (*Id.*) In these prior submissions defendants contend that plaintiff engaged in tortious interference with defendants' attempt to make a deal with SQM for the sale of the assets of Cosayach for $140 million, $87 million of which plaintiff would receive in partial payment of defendants' debt to plaintiff, and that in not allowing that deal to be consummated plaintiff violated its obligation of good faith and fair dealing. The failure to fulfill a prerequisite for institution of the lawsuit is based on a condition in the participation agreement between State Street and the participants for instituting a lawsuit against them, in which defendants were not parties.

In addition, defendants object to pages 20-29 of the R & R holding that they have not established a meritorious counterclaim defense and to pages 39-43 of the R & R that they have not shown a lack of prejudice warranting vacatur of the default judgment. (*Id.* at 3-4.)

Plaintiff filed a response to defendants' objections to the R & R on October 4, 2002. Plaintiff challenged every argument of defendants, contending that none of the seven counterclaim defenses had merit and that plaintiff would be prejudiced if the default judgment was vacated. (Pl.'s Reply Mem. at 7- 14.) Plaintiff relies on the evidentiary hearing before the magistrate judge and New York law, citing *Astor Holdings, Inc. v. Roski,* No. 01 Civ.1905, 2002 WL 72936, at *19 (S.D.N.Y. Jan. 17 2002) (Lynch, J.) to support its contention that defendants' tortious interference contention cannot constitute a meritorious defense and should be rejected. (Pl.'s Reply Mem. at 14-17.)

Plaintiff also asserts that defendants, in now arguing that plaintiff violated its contractual duty of good faith and fair dealings in demanding collateral before it would give consent to defendants' concluding negotiations with a third party for the sale of the assets of Cosayach, have stated a new defense not raised previously before the district court or the magistrate judge. They contend that defendants cannot raise anything other than what the district court referred to the magistrate judge, and that in any event the contention lacks merit and should be dismissed. (*Id.* at 17-21.)

In its final argument, plaintiff contends that defendants' objections are not sufficiently specific to warrant de novo review by the district court, and that absent a finding of clear error the R & R should be adopted as the opinion and judgment of the court. (*Id.* at 21-24.)

In a reply filed on October 7, 2002, defendants for the most part reiterate in summary form their original arguments. (*See* Defs.' Lt. Reply.)

DETERMINATION

In arguing for the first time that plaintiff has violated its implied covenant of good faith and fair dealing in not consenting to defendants consummating a $140 million deal without first receiving new collateral, defendants have rephrased their good faith and fair dealing counterclaim defense into a seemingly hybrid tortious interference violation of the implied covenant of good faith and fair dealing counterclaim defense. This defense could be dismissed summarily since defendants did not raise this as one of their meritorious counterclaim defenses either before the district court or the magistrate judge. As indicated ante, they were specifically limited to fuller exploration of only those counterclaim defenses raised in the district court which had been referred to the magistrate judge for further inquiry pursuant to Rule 55(c), F.R. Civ. P.

Defendants' tortious interference objection does not seem to comply sufficiently with the specifications of Rule 72(b) since filing prior submissions before the district court and the magistrate cannot qualify as the required specific objections to the R & R. *Camardo v. General Motors Hourly-Rate Employees Pension Plan,* 806 F.Supp. 380, 381-82 (W.D.N.Y.1992) (stating that it is "improper . . . to attempt to relitigate the entire content of the hearing before the Magistrate Judge by submitting papers to a district court which are nothing more than a rehashing of the same arguments and positions taken in the original papers submitted to the Magistrate Judge"); *Barratt v. Joie,* No. 96 Civ. 0324, 2002 WL 335014, at *1 (S.D.N.Y. March 4, 2002) (Swain, J.) ("[w] hen a party . . . simply reiterates his original arguments, the Court reviews the Report and Recommendation only for clear error") (citing *Camardo,* 806 F.Supp. at 382.).

Defendants' objection to pages 29-39 of the R & R to the effect that they have not made out a meritorious defense and/or counterclaim and to pages 39-43 of the R & R to the effect that they have not shown that plaintiff would be subject to an impermissible level of prejudice (Defs.' Obj. at 3-4) constitute generalized objections which do not require de novo review. *Greene v. WCI Holdings Corp.,* 956 F.Supp. 509, 517 (S.D.N.Y.1997) (Edelstein, J.); *see also Vargas v. Keane,* No. 93 Civ. 7852, 1994 WL 693885, at *1 (S.D.N.Y. Dec. 12, 1994) (Mukasey, J.).

However, the court has reviewed this matter de novo because dispositions on procedural grounds are generally not favored, and in view of the sum of money at stake, a study of the record and the law by both the magistrate judge and the court should provide double assurance that the final disposition is a fair one.

The tortious interference defense, for example, as originally stated, was that plaintiff had caused Inverraz to fail in negotiating with SQM for the sale of the assets of Cosayach for $140 million by giving SQM notice of this litigation and requiring it not to come to an agreement in the negotiations without their consent.

The evidence shows, however, that SQM was advised of litigation against Inverraz, filed on March 26, 2001, in New York state court by Bank of New York's ("Bony") Chilean lawyer shortly thereafter. The state court litigation is totally unrelated to this case. (Tr. at 50, 221; Pl. Exh. 1.) After learning on March 26, 2001, of the Bony litigation, at the next meeting of SQM and Inverraz SQM announced that it would not conclude the Cosayach negotiations without the "written permission of those who had started the lawsuit." (*Id.* at 189-90, 223.) This case was not instituted until April 16, 2001, and a copy of the complaint was subsequently forwarded to SQM.

In ¶¶ 42-44 of the complaint, plaintiff alleges that the proposed sale of the assets of Cosayach to SQM would violate both the 1994 and 1996 credit agreements because under the terms of those agreements, while in default in payments of the loan, Inverraz could not sell its own assets or those of certain of its subsidiaries termed "restricted subsidiaries." By letters of April 24 and 26, 2001, Inverraz promised plaintiff's counsel that it would not sell any of Cosayach's assets to SQM without plaintiff's prior consent. (Tr. at 56; Pl. Exh. 2.) Negotiations among defendants SQM and the lenders continued, but on October 5, 2001, SQM advised Inverraz that it would not close the deal. (Tr. at 36, 67; Pl. Exh. 6.) In its letter terminating further negotiations SQM refers to both "internal and external" difficulties as cause for its action. (Pl.Exh. 6.)

Under New York law, which is controlling, a viable tortious interference with a prospective contract claim must establish a business relation with a third party, defendants' interference with that relationship, which interference was for the sole purpose of harm to plaintiff or that improper, dishonest, or unfair means were used, and that injury to the business relationship occurred. *See Astor Holdings, Inc.*, 2002 WL 72936, at * 19 (citing *Nadel v. Play-by-Play Toys & Novelties Inc.*, 208 F.3d 368, 382 (2d Cir.2000) (citations omitted)).

At the time of the SQM negotiations Cosayach was a Restricted Subsidiary, defined to include any Chilean company of which Inverraz directly or indirectly owned 75 percent of the voting stock or held a 75 percent financial interest. (Defs.' Exh. G and K, § 10B). Jorge Sims, chair of the Inverraz Board, conceded that Cosayach was a restricted subsidiary (Tr. at 202, 234), and Inverraz was unquestionably in default at the time of the attempted sale. (*Id.* at 232.) Plaintiff had every right to insist that Cosayach assets not be sold without its permission, and its insistence that defendants adhere to their bargain cannot support a tortious interference claim, since it was an understandable attempt by plaintiff to protect its considerable financial investment.

Defendants' allegation that SQM chose not to proceed without the consent of the American lenders because, after receipt of threats from Bony and plaintiff, it did not want to jeopardize its relationships with American financial institutions (*id.* at 57), and the Senator's testimony that the deal fell through because Bony and plaintiff unreasonably withheld consent (*id.* at 66) is belied by the record. Moreover, even if it were true, plaintiff could not be guilty of tortious interference with the contract negotiations because under the circumstances such action would have been motivated by protection of plaintiff, not harm to Inverraz.

Defendants' new hybrid "implied covenant of good faith and fair dealing and tortious interference" claim is without merit as well. This claim, a variation of the one just discussed, seems to be that plaintiff acted with a bad faith purpose because it sought as a price for giving consent to the sale of Cosayach's assets to SQM for $140 million, $87 million of which would be applied to the $140 million owed plaintiff to extract from Inverraz additional collateral and other economic benefits to which it was not entitled, thereby violating its implied covenant of good faith and fair dealing. By withholding its consent under such circumstances, plaintiff is alleged to have "frustrated the Chilean defendants' reasonable contractual expectations that: (a) their assets could be sold to pay their debt to the plaintiff and (b) the plaintiff would facilitate, not prevent, the sale of assets for this purpose." (Defs.' Obj. at 11, emphasis and caps removed). Thus, the argument concludes plaintiff's bad faith refusal deprived defendants of $140 million to pay plaintiff and other senior creditors, causing damages which constitute a complete defense to plaintiff's claims. (*Id.* at 12.) Defendants cite a long series of New York and federal case law, Restatement of Contracts, other treatises and a Harvard Law Review article (*see id.* at 19-40), discussing the implied covenant of good faith and fair dealing. Unfortunately, the cited legal authority is totally inapposite.

The implied covenant of good faith and fair dealing applies to the performance and execution of an existing contract. Neither party may act to deny the other the fruits of the contract. *Bank of New York v. Sasson*, 786 F.Supp. 349, 353 (S.D.N.Y.1992) (Mukasey, J.). This implied covenant does not require a party to act against his own self interest even though the other party's interest may be incidentally adversely affected by the party's action. *M/A—COM Sec. Corp. v. Galesi*, 904 F.2d 134, 136 (2d Cir.1990) (per curiam); *Van Valkenburgh, Nooger & Neville, Inc. v. Hayden Pub. Co.*, 30 N.Y.2d 34, 46 (1972). The plaintiff had the right to withhold its consent to the sale of Cosayach's assets because under the terms of the agreements it was a restricted subsidiary which Inverraz could not sell while in default on payment of the loan. As we have seen, Cosayach was a restricted subsidiary and Inverraz was in default.

There was no explicit language in the loan agreements or guaranty that the parties may not unreasonably withhold its consent, leaving it free to withhold consent for any reason and "no implied obligation to act in good faith exists to limit the choice." *Teachers Ins. and Annuity Ass'n of Am. v. Wometco Enters., Inc.*, 833 F.Supp. 344, 349 (S.D.N.Y.1993) (Sprizzo, J.) (holding that a party's insistence that, before it will consent to refinancing proposal, the other party must agree to new terms was not a breach of good faith). Nor does the covenant apply to settlement negotiations, extensions, or modifications of the existing contract. *See Sasson*, 786 F.Supp. at 354; *Village on Canon v. Bankers Trust Co.*, 920 F.Supp. 520, 535 (S.D.N.Y.1996) (Koeltl, J.). Thus, this counterclaim defense cannot survive.

Defendants seem confused as to the status of the case before the magistrate judge. They place great reliance on *Davis v. Musler*, 713 F.2d 907, 916 (2d Cir.1983), *Keegel v. Key West & Caribbean Trading Co.*, 627 F.2d 372, 374 (D.C.Cir.1980) and cognate cases in which further fact finding was needed before the motion for default judgment could be upheld. In *Keegel,* the court indeed stated that defendants' allegations as to a meritorious defense were sufficient if they contained "even a hint of a suggestion" which if proved at trial would be a complete defense. Unfortunately for defendants this case has moved beyond the status of *Davis, Keegel* and the others relied on.

In none of those cases had there been any fact finding. Defendants had not been permitted to present any evidentiary proof in support of their contentions that they had a meritorious defense. Indeed, in *Davis,* the Second Circuit faulted the district judge for not using Rule 55(c) to allow further exploration of the meritorious defense claim. Defendants' argument would have been on point if the motion to vacate the default judgment had been denied while the matter was initially before the district court without defendants being given the opportunity to provide some evidence that they had a meritorious defense. The referral to Magistrate Judge Maas was for the purpose of allowing defendants to provide evidence that the default had not been willful, that they had a meritorious defense, and a lack of prejudice to plaintiff if the default judgment was not vacated.

Keegel's "hint of a suggestion of a meritorious defense" is no longer applicable. Defendants no longer write on a blank page. The page is filled with testimony of the principal defendants concerning their activities relevant to the loan agreements and guaranties undertaken. Defendants cannot now articulate a meritorious defense or even as a "hint of a suggestion" of such when the evidentiary record makes clear what is articulated or hinted has no merit.

Although defendants must supply more than a hint of a suggestion that a meritorious defense exists, even at this stage of the proceedings they are not required to make a showing of such a defense with the finality necessary in a trial on the merits. *Davis v. Musler,* 713 F.2d at 916 ("a defendant seeking to vacate a default judgment need not conclusively establish the validity of the defense(s) asserted") (internal citations omitted). When, as here, defendants have been given the opportunity to show that a viable defense exists, they are required to provide some credible indication that if the default judgment is vacated, defendants will be able at trial to establish with finality a meritorious defense which has a reasonable chance of carrying the day.

This the defendants have been unable to do. They keep repeating or rephrasing the claims asserted at the outset before the district court and reiterated before the magistrate judge. The assertions are now empty cant either without support in the record or at war with the evidence thus far adduced. Since defendants have the burden of proof, their failure, when given the opportunity, to establish even the rudimentary elements of a meritorious defense is fatal.

Defendants claim they have not had the opportunity to secure evidence from plaintiffs. Yet, when on April 3, 2002, preparation for the evidentiary hearing was being discussed, defendants requested only some supplemental responses from plaintiff to their interrogatories which they stated would suffice. At the April 3 conference it was clear that the magistrate judge would have ordered plaintiff to provide any evidence reasonably sought. A claim now that they did not have the opportunity to secure needed evidence to flesh out a meritorious defense will not suffice. Moreover, the court's instructions in referring the case to Magistrate Judge Maas are clear: "the factual record regarding defendants' seven remaining counterclaims is simply too incomplete for the court to conclude one way or the other whether they constitute meritorious defenses. . . . After defendants have been given an opportunity to flesh out the factual foundation for each counterclaim, Magistrate Judge Maas will decide" the nature of the defense. *State Street Bank and Trust Co.*, at 323. There could be no misunderstanding from that language that the purpose of the reference to the magistrate judge was to provide defendants with a forum before which they could show a sufficient evidentiary basis for setting this matter down for trial on the merits. It now seems evident that defendants have failed to present proof even minimally sufficient to show the existence of a meritorious defense because they have no meritorious defense. The Senator, his son, and Sims insist on misstating the terms of the agreements, and defendants' counsel repeats these misstatements in asserting that valid counterclaims and defenses exist, but the constant repetition of untruths cannot remove their falsity.

As to the other counterclaim defenses: (1) fraudulent and negligent misrepresentations, (2) good faith and fair dealing, (3) fiduciary duty owed under the Credit and Guaranty Agreements, (4) lack of standing by plaintiff to institute this litigation without fulfilling condition precedent, (5) improper restriction in default judgment, (6) improper guarantors as defendants and (7) the issue of prejudice to plaintiff, Magistrate Judge Maas has carefully and thoroughly measured all of these issues against the evidence adduced at the May 23-24 hearing before him, made findings of fact and conclusions of law and, having considered the applicable legal principles, concluded in each instance that defendants had not met their burden of stating a meritorious counterclaim defense and that plaintiff would be subject to an impermissible level of prejudice if the default judgment was vacated. The court finds his determinations to be correct both on the facts and the law.

For the reasons articulated in the R & R, the court incorporates the findings of fact and conclusions of law of the magistrate judge on those issues in the opinion and judgment of the court. The court also adopts the uncontested R & R of the magistrate judge that the default was not willful.

In sum, it is the opinion and judgment of the court that while the default was not willful, defendants have failed to establish a meritorious defense or that plaintiff would not be prejudiced if the default judgment is vacated.

Accordingly, defendants' motion to vacate the default judgment is denied.

IT IS SO ORDERED.

Dated: New York, New York
November 5, 2002

s/ Robert L. Carter
ROBERT L. CARTER
U.S.D.J.

APPENDIX D — REPORT AND RECOMMENDATION TO THE HONORABLE ROBERT L. CARTER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED AUGUST 15, 2002

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

No. 01 Civ. 3201(RLC)

STATE STREET BANK AND TRUST CO.,

Plaintiff,

v.

INVERSIONES ERRAZURIZ LIMITADA, et al.,

Defendants.

REPORT AND RECOMMENDATION TO THE HONORABLE ROBERT L. CARTER

FRANK MAAS, United States Magistrate Judge.

I. *Introduction*

In this action, Plaintiff State Street Bank and Trust Company ("State Street") seeks extensive damages as a consequence of the Defendants' default under Credit and Guaranty Agreements entered into in 1994 and 1996. On November 16, 2001, the Court (Carter, J.) granted State Street's motion for a default judgment, and on November 30, 2001, the Clerk of the Court entered a default judgment in the total amount of approximately $140 million.

On December 19, 2001, the Defendants filed a motion to vacate the default judgment which, in turn, led to the referral of certain issues to me for further inquiry. Following a two-day evidentiary hearing and a review of the parties' extensive briefing, I have concluded that the Defendants' motion should be denied and so recommend.

II. *Factual Background*

A. *The Underlying Transactions*

Although the agreements between State Street and the Defendants have been described as "long and complicated," (Tr. 136-37),[1] the basic transactions giving rise to this suit are straightforward. In brief, State Street supplied a Chilean entity known as Inversiones Errazuriz Limitada ("Inverraz") with two credit facilities: $50 million under a 1994 Credit Agreement and $65 million (in two tranches) under a 1996 Credit Agreement. (Compl.¶¶ 16, 23). To induce State Street to enter into this financing, various Inverraz subsidiaries signed Guaranty Agreements in 1994 and 1996. More specifically, Commercial e Inmobiliaria Unimarc S.A., Pesquera Nacional S.A., Cidef S.A., Salmones Unimarc S.A., and Industria Forestal Nacional S.A. signed the 1994 Guaranty Agreement ("1994 Guaranty"). (Defs.' Ex. I). Each of the 1994 Guarantors, as well as Compania de Salitre y Yodo Primera Regin S.A. ("Cosayach") and Cidef Argentina S.A., signed the 1996 Guaranty Agreement ("1996 Guaranty").[2] (*Id.* Ex. F). None of the Defendants has made any payments to State Street with respect to Inverraz's indebtedness since 1999. (Tr. 44-45, 343).

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[1] "Tr." refers to the transcript of the evidentiary hearing held in this case. "Pl.'s Ex." refers to the exhibits introduced at the hearing by State Street. "Defs.' Ex." refers to the exhibits introduced at the hearing by the Defendants.

To determine whether the Defendants' motion to vacate the default judgment has merit, one must understand certain details of both the loan documents and the interactions among the parties. Accordingly, I will turn to each of these issues in turn.

B. *Loan Documentation*

1. *Credit Agreements*

Both loans to Inverraz were memorialized by Credit Agreements which, insofar as relevant here, are substantially similar in form. Both Credit Agreements required Inverraz to repay the loans in semiannual installments and provided that the failure to make timely payments constituted an Event of Default. (Defs.' Exs. G ¶ 7A, K ¶ 7A). State Street was entitled to accelerate Inverraz's indebtedness when an Event of Default occurred, in which case all of the interest and principal then outstanding, together with a "Make Whole Amount" would become immediately due and payable. (*Id.*).

The Credit Agreements both required as a condition of closing that certain Inverraz affiliates guarantee the loans through an

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[2] The 1994 Guaranty and 1996 Guaranty are hereinafter referred to, collectively, as the "Guaranties." The Guarantors under both Guaranties are referred to, collectively, as the "Guarantors."

"Affiliate Guaranty." (*Id.* ¶ 3I). The 1994 Guaranty and the 1996 Guaranty are those Affiliate Guaranties.

The 1994 Credit Agreement defines the Guarantors required to sign the Affiliate Guaranty as the five companies that signed the 1994 Guaranty. (Defs.' Ex. G ¶ 10B). The 1996 Credit Agreement contains a considerably more complicated provision which defines the term "Guarantors" to include

> as of the first Closing Date, the Original Guarantors and, on any date thereafter, the Original Guarantors and any other Eligible Subsidiary which shall have become a Guarantor pursuant to paragraph 5L, provided that a Guarantor shall cease to be a Guarantor upon its release from its obligations under the Affiliate Guaranty in accordance with paragraph 20 thereof.

(Defs.' Ex. K ¶ 10B). Pursuant to Paragraph 5L of the 1996 Credit Agreement (and Paragraph 20 of the Guaranties), certain entities that had previously served as Guarantors of the 1996 loans might be released from further liability on any one of a number of predetermined Liability Calculation Dates (Defs.' Exs. F ¶ 20, I ¶ 20, K ¶ 5L).

2. *Guaranties*

Under the terms of both Guaranties, the Guarantors each unconditionally agreed to pay a share of Inverraz's indebtedness which was referred to as its "Attributable Liability." (Defs.' Exs. F ¶ 3, I ¶ 3). Moreover, because the Guaranties guaranteed both payment and performance, not merely collectibility, State

Street was not required to attempt to collect the outstanding loan balances from Inverraz before proceeding against the Guarantors in the event of a default. (*Id.*).

The Guaranties further provided that if,

> for any reason, a Guarantor fails to pay its Attributable Liability (the Guarantor in each case being referred to as the "Bankrupt Guarantor"), then the Attributable Liability of each non-Bankrupt Guarantor for the Guaranteed Obligations shall be increased by its pro rata [share of the Bankrupt Guarantor's Attributable Liability].

(*Id.* Defs. Exs. F ¶ 4, I ¶ 4). Thus, to the extent that any Guarantor proved unwilling or unable to honor its Guaranty, the liability of the remaining Guarantors under that Guaranty would be proportionally increased.

One key difference between the 1994 and 1996 Guaranties relates to the term "Guarantor." Although neither Guaranty contained a definition of the term, both provided that any undefined terms "shall have the respective meanings given therefor in the [applicable] Credit Agreement." (Defs.' Exs. F ¶ 1, I ¶ 1). The 1994 Credit Agreement, in turn, defined the term Guarantor by listing the five companies that had signed the 1994 Guaranty. (Defs.' Ex. I ¶ 10B).

The 1996 Credit Agreement defined the "Original Guarantors" as the seven entities that signed the 1996 Guaranty. With respect to the "Eligible Subsidiaries" that might subsequently become Guarantors, Paragraph 5L(a) of the 1996 Credit Agreement provided, insofar as relevant, as follows:

> On each Liability Calculation Date each Eligible Subsidiary which shall be a Material Subsidiary as of such date (each, an "Eligible Material Subsidiary") and, in the event that the percentage of Consolidated Total Assets held by such Eligible Material Subsidiaries on such Liability Calculation Date shall be less than 90 %, each other additional Eligible Subsidiary whose Total Assets, together with the Total Assets of such other additional Eligible Subsidiaries and such Eligible Material Subsidiaries, equals or exceeds 90 % of Consolidated Total Assets on such date shall become, effective as of such Liability Calculation Date, . . . a Guarantor under the Affiliate Guaranty on such Liability Calculation Date. The determination of which additional Eligible Subsidiaries shall become or continue to be Guarantors shall be made on the basis of the percentage of Consolidated Total Assets . . . beginning with the additional Eligible Subsidiary with the largest such percentage and continuing until the percentage of Consolidated Total Assets held by all of the Guarantors on such Liability Calculation Date equals or exceeds 90 %.

(Defs.' Ex. K ¶ 5L(a)).

The term "Material Subsidiary" was defined in the 1996 Credit Agreement to include any Eligible Subsidiaries which held at least 5 % of the Consolidated Total Assets[3] of all of the Eligible Subsidiaries. (*See id.* ¶ 10B).

As a consequence of these provisions, after the first Liability Calculation Date, the Guarantors under the 1996 Credit Agreement included every Eligible Material Subsidiary of Inverraz. If those Eligible Material Subsidiaries did not collectively own 90 % of the Consolidated Total Assets of all of the Eligible Subsidiaries of Inverraz, then other Eligible Subsidiaries had to be added to the list of Guarantors—starting with the largest Eligible Subsidiary—until the 90 % threshold was met. (*Id.*).

3. *Negative Covenants*

In addition to requiring that there be Guarantors of the Inverraz indebtedness, State Street protected its financial investment through a series of restrictive covenants in the Credit Agreements. (Defs.' Exs. G ¶ 6, K ¶ 6). Among other limitations, Inverraz agreed that it would sell its own assets and those of certain "Restricted Subsidiaries" only under limited circumstances and only if it was not, and would not thereby become, in default of its obligations under the loans. (Defs.' Exs. G ¶ 6(C)(4)(iv), (v), K ¶ 6(C)(4)(iv), (v)). The Credit Agreements defined the term "Restricted Subsidiary" to include "each of the Guarantors" and any other entity in certain countries, including Chile, of which Inverraz, either directly or indirectly through other Restricted Subsidiaries, owned 75 % or more of the voting stock or held a 75 % financial interest. (Defs. Exs. G

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[3] Both Credit Agreements defined "Consolidated Total Assets" as the aggregate tangible assets of Inverraz and its Restricted Subsidiaries on a consolidated basis. (Defs.' Exs. G at 27, K at 38).

¶ 10B, K ¶ 10B). Although the guarantors did not sign the Credit Agreements, in each Guaranty they agreed to be bound by the terms of the relevant Credit Agreement. (Defs.' Exs. F, I ¶ 10).

4. *Participation Agreements*

At the time of both loan transactions, State Street entered into agreements with other lenders, known as participants, pursuant to which it sold its entire interest in the loans, but nevertheless remained responsible for their servicing and collection. (Defs.' Ex. N ¶ 4). Among other duties, State Street was specifically charged with making demands upon Inverraz and its Guarantors and enforcing the participants' rights. (*Id.* ¶¶ 4(a), (j)). State Street further agreed in each Participation Agreement that it would "not exercise any . . . rights or powers [it] may have . . . in respect of the Loan . . . except at and in accordance with the written instruction of" participants owning more than 50 % of the participation interests. (*Id.* ¶¶ 4(j), 17). The Participation Agreements provided, however, that "[a]ll of the understandings and agreements contained in this Agreement are solely for the benefit of the [State Street] and the Participants and there are no other parties (including [Inverraz]) that are intended to be benefitted in any way or relieved of any obligations to [State Street] or any of the Participants."[4] (*Id.* ¶ 18).

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[4] Although the parties did not introduce into evidence a complete copy of the 1996 Participation Agreement, I assume, as have the Defendants, that the material terms of both Participation Agreements are identical. (*See* Defs.' Mem. at 75-87).

D. *Inverraz's Default*

Inverraz made the payments required by the Credit Agreements through 1998. Beginning in 1999, however, Inverraz failed to make four consecutive semiannual installment payments. (Tr. 230-31). Initially, State Street agreed to defer the 1999 payments in exchange for a higher interest rate. (*Id.* at 44). Thereafter, on January 22, 2001, following Inverraz's continued failure to make its scheduled payments in 2000, (*id.* at 231), State Street accelerated Inverraz's entire indebtedness and demanded immediate repayment of all sums then due. (*Id.* at 44). Despite this demand, neither Inverraz nor any of its Guarantors has repaid any portion of Inverraz's substantial outstanding indebtedness since the notice of acceleration was sent. (*Id.* at 343).

III. *Procedural History*

Following Inverraz's default, State Street commenced this action by the filing of its complaint on April 16, 2001. (Docket No. 1). On June 27, 2001, the Court "so ordered" a stipulation pursuant to which the Defendants acknowledged personal jurisdiction and service; in return, State Street extended the Defendants' time to answer or move until June 19, 2001. (Docket No. 4). The stipulation extending time is somewhat unusual in two respects: *first,* rather than appearing by counsel, the Defendants signed the stipulation themselves through their corporate officers (Tr. 117-18, 303-04); *second,* the date by which the stipulation required the Defendants to respond had already passed when it was filed (*id.* at 22). Notwithstanding the extension of time that they were afforded, over the next three months the Defendants neither answered nor moved with respect to the complaint.

On September 27, 2001, State Street moved for the entry of a default judgment. In an affidavit submitted in connection with this motion by one of its vice-presidents, State Street represented that the Defendants owed more than $55 million under the 1994 Credit Agreement and more than $78 million under the 1996 Credit Agreement, with interest under both Agreements continuing to accrue at the rate of more than $20,000 per day. (Affidavit of Fred Epstein, sworn to on Sept. 21, 2001, ¶¶ 41, 47). The Defendants were served with State Street's motion papers in the manner prescribed in the stipulation extending their time to answer, but submitted no opposition papers.

By order dated November 20, 2001, the Court granted State Street's motion. (Docket No. 13). Thereafter, on November 30, 2001, the Clerk of Court signed a default judgment which was entered on the Court's docket on December 4, 2001. (Docket No. 14). The default judgment awards the following relief:

> (a) under the 1994 Credit Agreement and Guaranty, judgment in the amount of $57,283,874.86, together with prejudgment interest from November 1, 2001, at the rate of $20,011.63 per day, against defendants Inverraz, Supermercados Unimarc S.A., Pesquera National S.A., Unimarc Abastecimientos S.A., Cidef S.A., Salmones Unimarc S.A., Industria Forestal Nacional S.A., Forestal Regional S.A., and Corporacion De Inversiones Y Desarrollo Financiero Cidef S.A., jointly and severally;

> (b) under the 1996 Credit Agreement and Guaranty, judgment in the amount of $79,180,000.12, together with prejudgment interest from November 1, 2001, at the rate of $21,599.47 per day, against defendants Inverraz, Supermercados Unimarc S.A., Pesquera National S.A., Unimarc Abastecimientos S.A., Cidef S.A., Salmones Unimarc S.A., Cidef Argentina S.A., Corporacion De Inversiones Y Desarrollo Financiero Cidef S.A., and Sociedad Contractural Minera Compania De Salitre Y Yodo Primera Region, jointly and severally; and
>
> (c) an order directing that the named defendants "may not sell or transfer assets of Compania de Salitre y Yodo de Chile S.A., without plaintiff's prior consent."[5]

(*Id.*).

On November 8, 2001, the Law Office of Michael B. Wolk, P.C., served a notice of appearance in this action on behalf of all of the Defendants which apparently was not filed with the Clerk of the Court until December 15, 2001. (Docket No. 15). Thereafter, on December 19, 2001, Mr. Wolk moved, pursuant to Fed.R.Civ.P. 60(b), to vacate the default judgment. Rule 60(b) provides that a court may relieve a party from a final judgment for several reasons, including "mistake, inadvertence, surprise, or excusable neglect." To determine whether a default judgment resulted from excusable neglect, courts generally consider "(1) whether the default was willful, (2) whether defendant has a meritorious defense; and (3) the level of prejudice that may occur to the non-defaulting party if relief is granted." *Am. Alliance Ins. Co. v. Eagle Ins. Co.*, 92 F.3d 57, 59 (2d Cir.1996)(quoting *Davis. v. Musler,* 713 F.2d 907, 915 (2d Cir.1983)). The burden of showing that vacatur is justified rests with the moving party. *Sony Corp. v. Elm State Elec.*, 800 F.2d 317, 320 (2d Cir.1986).

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[5] A corrected default judgment reflecting minor textual changes was entered on May 8, 2001. (Docket No. 38).

In their motion papers, the Defendants alleged that their long time United States counsel, Gibson, Dunn, & Crutcher ("Gibson, Dunn"), had unexpectedly abandoned them shortly after the filing of State Street's motion for a default judgment. (Defs.' Mem. 92-93). The Defendants further contended that they had eight potentially meritorious defenses or counterclaims that they wished to assert. (*Id.* at 75-120; Defs.' Reply Mem. 5-12).

On February 4, 2002, Your Honor issued an Opinion which indicated that the Defendants would likely be able to sustain their burden of showing that the default was not willful if they were able to establish that it was caused by their "good faith (if erroneous) expectation that Gibson, Dunn would continue to represent their interests in litigation against plaintiff" and "their attendant inability to find new [ ] representation." *State Street v. Inversiones Errazuriz Limitada,* No. 01 Civ. 3201, 2002 WL 181697, at *3 (S.D.N.Y. Feb. 4, 2002). Because the Defendants had not yet proffered sufficient evidence to establish that this was so, the wilfulness of the default was referred to me for further inquiry. *Id.* at *318. I also was directed to consider (a) whether there was a factual basis for certain of the Defendants' proposed counterclaims, and (b) whether State Street would suffer any unfair prejudice if the default judgment were vacated. *Id.* at 323.

Pursuant to the reference, I authorized certain limited discovery requested by the parties and then held an evidentiary hearing on May 23 and 24, 2002. At the hearing, the Defendants called four witnesses: Jorge Sims, the Chief Executive Officer and President of Inverraz; Senator Francisco Javier Errazuriz (the "Senator"), a member of the Chilean legislature, whose family controls the Inverraz group of companies; the Senator's son, Francisco Javier Errazuriz-Ovalle ("Francisco"), who is the General Manager of Inverraz; and Nelson Contador, a Chilean attorney who serves as outside counsel for the Inverraz group of companies. State Street's only witnesses were Conor D. Reilly and Blake Franklin, both of whom are partners at Gibson, Dunn.

My findings of fact and conclusions of law, based upon the testimony of these witnesses and the relevant exhibits, are set forth below.

IV. *Findings of Fact and Conclusions of Law*

A. *Wilfulness*

The relationship between Gibson, Dunn and Inverraz dates back to 1983, when the Senator arrived at Blake Franklin's office to seek assistance in the structuring of transactions to export fruit from Chile to the United States. (*Id.* at 8, 351). Over the next two decades, Franklin and his colleagues at Gibson, Dunn handled a variety of legal work for Inverraz in the United States. Among other assignments, Gibson, Dunn served as counsel to the Defendants in connection with both the 1994 and 1996 loans. (*Id.* at 8).

When State Street accelerated the Inverraz debt, the Defendants naturally looked to Franklin and his firm for help. In late 2000, the Senator and Franklin met with representatives of State Street in New York City to discuss the possibility of restructuring Inverraz's obligations. (Tr. 10-11, 353-54). During these discussions, the Senator agreed that he would sell certain of Inverraz's assets in an effort to repay its past due debt. (*Id.* at 10-11). Over the next few months, Inverraz unsuccessfully attempted to close several such transactions. (*Id.* at 36, 293).

The parties' efforts to work out the loans continued even after this suit was filed in April 2001. Indeed, it appears that the parties were operating under an informal standstill agreement, pursuant to which State Street agreed not to pursue its remedies under the Credit Agreements and Guaranties in this lawsuit without giving the Defendants at least one week's advance notice. (*Id.* at 127).

The notion that the parties were proceeding cooperatively during this period is underscored by the stipulation extending the Defendants' time to respond to the Complaint. As noted earlier, the stipulation was submitted to the Court for its approval even though the date by which the Defendants were to respond had already expired. Indeed, the principal purpose that the stipulation appears to have served was not to set a date for the Defendants to answer or move, but, rather, to secure an acknowledgment that service was effective and establish a means by which subsequent papers could be served upon the Defendants' designated agent in the United States. As the Senator explained, the Defendants did not wish to serve an answer for fear that it would derail their ongoing discussions with State Street regarding a workout of the Inverraz loans. (*Id.* at 109).

On July 20, 2001, State Street's counsel sent a letter to Reilly which signaled the end of the litigation timeout and warned that both State Street and another Inverraz creditor, the Bank of New York ("BONY"), might seek the entry of default judgments against the Defendants as early as the following week. Despite that notice, the two sides continued to engage in workout discussions. (*Id.* at 149). As a result, by early August, they appeared to have reached an agreement in principle, pursuant to which Inverraz would sell Cosayach's iodine and nitrates business to a competitor, Sociedad Quimica y Minera de Chile S.A. ("SQM"), and use a portion of the sale proceeds to repay State Street approximately $85 million plus $2 million in legal fees. (Tr. 59; Pl.'s Ex. 4). At or about the same time, the two sides were also discussing a possible sale of Inverraz's supermarket subsidiary to raise further funds for repayment of the loans. (Pl.'s Ex. 9).

Despite these discussions, the possibility that State Street might seek a default judgment always loomed. To make matters worse, whether Gibson, Dunn would represent the Defendants in this action was a matter within the purview of the firm's litigators, not lawyers, such as Franklin, who had a continuing business relationship with Inverraz and the Senator. As Reilly cautioned Jose Dulanto, Inverraz's in-house counsel, in a May 1, 2001, letter, Gibson, Dunn was unwilling to consider undertaking that assignment until "after [its] outstanding invoices have been paid." (Pl.'s Ex. 8).

There is a sharp dispute between the Senator and his former attorneys as to whether Gibson, Dunn was reluctant to enter the litigation fray because Inverraz was in arrears, because it knew of no potentially meritorious defense, or both. (Tr. 24, 116, 357-

58). There is also a dispute as to whether Gibson, Dunn ever unequivocally told representatives of Inverraz that its litigators were unwilling to represent the Defendants in connection with this suit. (*Id.* at 116-19, 188). State Street points to the fact that Gibson, Dunn was unwilling to sign the stipulation extending Inverraz's time to respond to the complaint as evidence that Gibson, Dunn's position had been effectively communicated.

The central issue, however, is not what Gibson, Dunn communicated, but whether the Defendants' inaction went beyond "gross negligence" and amounted to a wilful default. *See Am. Alliance,* 92 F.3d at 61. As Your Honor recognized, this inquiry must focus, first, on whether the Defendants had a "good faith (if erroneous) expectation that Gibson, Dunn would continue to represent their interests in litigation . . ." *State Street,* 2002 WL 181697, at *3. In that regard, Sims testified without contradiction that there is no distinction in Chile between corporate attorneys and litigators. (Tr. 218) ("Normally the same lawyers handle both things."). If so, it appears reasonable for the Defendants to have assumed that their interests were being adequately protected by Gibson, Dunn throughout the lengthy period that the parties and their counsel were attempting to renegotiate the terms of the Inverraz loans. Although hindsight suggests that the Defendants would have been wise to begin seeking other counsel during this period, a good faith belief that an action will settle constitutes a reasonable basis for failing to interpose an answer. *See Gonzalez v. City of New York,* 104 F.Supp.2d 193, 196 (S.D.N.Y.2000) (Scheindlin, J)("defendant's counsel held the reasonable belief that the action would be settled, thereby obviating the need for a formal response"); *Whitman v. United States Lines,* 88 F.R.D. 528, 530 (E.D.Tex.1980) (defendants' failure to answer the complaint because of good faith belief that case would be resolved by ongoing settlement negotiations constitutes "gross negligence," but nonetheless "excusable neglect").

By September 21, 2001, when the motion for a default judgment was filed, the situation clearly had escalated to the point that the Defendants had to take some steps to defend this suit. There is no indication that the Defendants instead opted to sit on their haunches. Quite to the contrary, as Franklin explained, when he and the Senator discussed whether it might be preferable for the Defendants not to appear, "[t]he Senator didn't agree with that and his Chilean counsel didn't agree with that." (Tr. 368; *see also id.* at 395-96).

In the course of their conversations in early October, Franklin also told the Senator that Inverraz would have to make a substantial payment to Gibson, Dunn so that Franklin could approach the litigators again about taking this case. (*Id.* at 369). That the Senator wished to pursue this course is persuasively demonstrated by his decision to wire transfer $200,000 from his financially-strapped company to Gibson, Dunn either that day or the following day. (*Id.*; Defs.' Ex. C). Given Inverraz's lengthy relationship with Gibson, Dunn, and the firm's familiarity with the underlying loan transactions, it is understandable that the Defendants would have preferred Gibson, Dunn to other counsel at this stage.

Moreover, the Defendants were not alone in their belief that Gibson, Dunn might relent and agree to represent them in this litigation. As Franklin testified, he too believed in early October that the payment of some of the fees that were in arrears would "convince the litigators to continue to represent a company that [he] thought was a very good client." (Tr. 386). Franklin also conceded during his testimony that the Senator may well have misinterpreted his request for the $200,000 as a request for a litigation retainer. (*Id.* 373). In these circumstances, there is no reason to believe that the Defendants' initial failure to respond to State Street's motion for a default judgment is attributable to a tactical decision.

After Gibson, Dunn communicated its unwillingness to represent the Defendants in this case despite Inverraz's $200,000 payment, the Defendants promptly sought other counsel. Although Franklin had suggested to the Senator during a visit to Chile in May 2001 that Gibson, Dunn would be able to suggest other law firms if the need arose, it does not appear that he followed through. Instead, Inverraz apparently was provided only with contact information for Your Honor's Chambers. (*Id.* at 286). The notion that a corporate borrower which had arrearages of nearly $140 million could realistically have sought relief through a telephone call or *pro se* letter to the Court is plainly not tenable. Accordingly, it is not surprising that neither State Street's counsel nor the Court heard from the Defendants for several weeks while they were searching for counsel.

Although neither side established the precise date, it is undisputed that the Defendants next contacted Oliver Armas, an attorney with Thacher Proffitt & Wood. (*Id.* at 31). In late October, the Thacher, Proffitt firm agreed to represent the Defendants, but soon concluded that it had a conflict in interest. (*Id.*). Thereafter, in early November, the Defendants retained their present counsel, Michael B. Wolk. (*Id.* at 32). Mr. Wolk served his notice of appearance on November 8, 2001, and sought to file further papers seeking to vacate the default judgment on December 17, 2001, the day after the automatic ten-day stay of enforcement expired. *See State Street,* at 317 n.2. After those motion papers were rejected, Mr. Wolk submitted further papers on December 19th. (Docket Nos. 16-20).

In short, less than one month after it became clear that Gibson, Dunn would not appear in this action, Mr. Wolk filed a notice of appearance. Some six weeks later, Mr. Wolk filed an extensive motion to vacate the default judgment. This motion was filed only two weeks after the default judgment actually was entered on the Court's docket and only a few days day after the automatic stay of enforcement expired on Friday, December 14, 2001.

Although State Street has criticized the pace of the Defendants' response to this suit, it is clear that the Defendants were faced with some unusual hurdles. First, each of the Defendants evidently is based in Chile and there is no indication that they had any representatives in the United States who were in a position to expedite their search for substitute counsel once Gibson, Dunn made it clear that it would not file a notice of appearance. Second, despite the fact that Franklin indicated to the Senator that he would, if necessary, find another law firm to appear on the Defendants' behalf, (Tr. 359), it does not appear that Gibson, Dunn ever furnished the Defendants with the names of any firms which might be able to assume their defense. Third, the complexity of the transactions giving rise to this suit meant that the law firms that could be approached were necessarily limited. Fourth, because the Senator and his colleagues are not native English speakers, it obviously was desirable that they secure counsel who could deal effectively with cross-border issues. Like Gibson, Dunn, Thacher, Proffitt appeared to fill that need.[6] Fifth, although they ultimately were able to retain Mr. Wolk, the Defendants' financial straits probably complicated their search. Finally, it is clear from the hearing that neither Mr. Wolk nor the only other attorney assisting him (his father, Edmund Wolk) is fluent in Spanish. The significant geographical and language constraints that Mr. Wolk faced, as well as the small size of his firm, undoubtedly affected his ability to mobilize quickly to contest the entry of the default judgment.

In these circumstances, it seems apparent that the Defendants' delay in responding to this action, even if negligent, cannot be characterized as "wilful." The Defendants have therefore met their burden with respect to this first element of the showing necessary to vacate the default judgment.

B. *Meritorious Defense or Counterclaim*

After concluding that the Defendants' first counterclaim lacked merit, Your Honor asked me to consider the merits of their seven remaining counterclaims. As set forth in your Opinion, those counterclaims are as follows:

> Second, defendants claim that plaintiff has engaged in activity that constitutes a breach of its implied obligation of good-faith and fair dealing under the Credit and Guaranty Agreements. [(Defs.' Mem.)] at 112. Third, defendants allege that plaintiff has engaged in knowing, intentional, and/or tortious

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[6] The Court takes judicial notice that Thacher, Proffitt has a Latin American Practice Group and that Mr. Armas, with whom the Defendants consulted, is apparently fluent in Spanish. (*See http:// www.thacherproffitt.com* (last visited July 29, 2002)).

> interference with defendants' contractual relations, business operations, and prospective economic advantage. *Id.* at 113-16. Fourth, defendants accuse plaintiff of having made fraudulent and/or negligent misrepresentations regarding their rights under the Credit and Guaranty Agreements. *Id.* at 116-17. Fifth, defendants claim that plaintiff has breached its fiduciary duty owed under the Credit and Guaranty Agreements. *Id.* at 118-120. Sixth, defendants argue that plaintiff's suit against them is defective because it violates the conditions for bringing suit set forth in the Credit and Guaranty Agreements. *Id.* at 75. Seventh, defendants contend that the default judgment filed by plaintiff is defective because it contains a declaratory ruling that restricts the assets of a company that is not even a party to the lawsuit. (Defs.' Reply Mem. at 5-9.) Eighth and finally, defendants contend that the default judgment is defective because it awards damages against four defendants who are not guarantors under either the 1996 or 1994 Credit Agreements, and two other defendants who are not Guarantors under the 1996 Agreement. *Id.* at 10.

State Street, at 322. Each of these counterclaims is considered below.

1. *Tortious Interference*

a. *SQM*

Several of the Defendants' counterclaims arise out of State Street's allegedly improper conduct in connection with Inverraz's proposed sale of Cosayach's nitrate and iodine assets to SQM. After extensive negotiations, Inverraz and SQM apparently reached an agreement in principle regarding this sale. (Tr. 11-12). Accordingly, as required by Chilean law, SQM notified the Chilean government of its intent to complete the transaction at a cost of approximately $140 million. (*Id.* at 18; Defs.' Ex. M).

Following the SQM filing, BONY filed an action in Supreme Court, New York County, on March 26, 2001, to recover from Inverraz approximately $40 to 50 million of indebtedness then due and owing under an unrelated credit agreement. (Tr. 50, 221; Pl.'s Ex. 1). BONY was represented in this action by Debevoise & Plimpton, the same firm that State Street had retained in connection with its dealings with Inverraz. In addition, BONY had separate counsel in Chile. After the state court suit was filed, BONY's Chilean counsel forwarded a copy of the complaint to SQM. (Tr. 221-22). At the very next meeting between Inverraz and SQM, the SQM representatives indicated that they would not complete the Cosayach transaction without the "written permission of those who had started the lawsuit." (*Id.* at 189-90; *see also id.* at 223).

A copy of the complaint in this action subsequently was forwarded to SQM in April 2001. In that complaint, State Street alleges that the completion of the proposed Cosayach transaction with SQM would violate both the 1994 and 1996

Credit Agreements because Inverraz had agreed not to sell the assets of Inverraz or certain of its subsidiaries, termed Restricted Subsidiaries, while Inverraz was in default. (Compl.¶¶ 42-44). In addition to this averment, the Defendants apparently contend that State Street "affirmatively warned" SQM that the proposed Cosayach transaction could not take place without its prior consent. (*See* letter from Michael B. Wolk, Esq. to the Court, dated June 12, 2002, at 4). The Defendants also allege that, after having been threatened by both State Street and BONY, SQM chose to condition the Cosayach transaction on the consent of both banks because it did not want to jeopardize its relationships with American financial institutions. (*Id.*; Tr. 57).

By letters dated April 24 and 26, 2001, Inverraz promised State Street's counsel that it would not sell any of Cosayach's assets to SQM without securing State Street's prior consent. (Tr. 54; Pl.'s Ex. 2). Although the negotiations among Inverraz, SQM, and the lenders then continued, (*see, e.g.*, Tr. 62; Pl.'s Ex. 5), on October 5, 2001, SQM notified Inverraz that it was unwilling to proceed to a closing. (Tr. at 36, 67; Pl.'s Ex. 6). At the hearing, the Senator testified that the deal fell through because BONY and State Street unreasonably withheld their consent. (Tr. at 66).[7]

b. *Tamaya Corporation*

The Defendants allege that State Street also interfered with Cosayach's relationship with Tamaya Corporation, the largest distributor of iodine in North America. Under BONY's contractual arrangements with Inverraz, certain Inverraz receivables attributable to export sales, including sales of iodine by Cosayach, had to be placed into a trust. (Tr. 326-27). The proceeds of domestic sales, however, were not subject to this restriction. (*Id.* at 327). After State Street declared its loan in default, BONY invoked a cross-default provision in its loan documentation. (*Id.* at 327-28). It appears that Tamaya then ceased making iodine purchases directly from Cosayach. Instead, Tamaya began to purchase its iodine through intermediaries in Chile. Those intermediaries would purchase the iodine required to fulfill Tamaya's needs through "local" purchases from Cosayach in Chile. In this manner, Cosayach was able to avoid depositing the sales proceeds into the trust. (Pl.'s Ex. 13).

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[7] The letter from SQM terminating further discussions references both "internal and external" difficulties that precluded the sale. (Pl.'s Ex. 6).

Although the Defendants allege that Inverraz's lenders at some point notified Tamaya (through Debevoise & Plimpton) that it was running a "big risk" if it purchased iodine by this means, (*id.* at 295), the documents paint a considerably different picture. After the issue arose, Tamaya's United States counsel sent Debevoise & Plimpton a letter, dated May 21, 2001, which asked whether Inverraz's lenders had any objections to Tamaya's purchases of Cosayach's iodine through local Chilean intermediaries. Among the specific inquiries that Tamaya's counsel made was:

> 1. Do the investors you represent object to sales of iodine produced by Cosayach to "local" Chilean companies and the resale of such Cosayach iodine to third parties . . . , payment being made as directed by such Chilean companies? If so, please provide us the legal basis for that objection. Please provide us copies of all documents upon which you rely in reaching your conclusions.

(Pl.'s Ex. 13). In response to this letter, Debevoise & Plimpton indicated that it was not authorized to take a position. As an alternative, the firm suggested that Tamaya's counsel confer with Cosayach or Inverraz, noting that the lenders had no objection to those entities furnishing Tamaya with copies of the relevant loan documentation. (Pl.'s Ex. 14; *see also* Pl.'s Exs. 15, 16). The Defendants' present criticism of this response, (*see* Tr. 335), is markedly different than their earlier reaction. At the time, Inverraz's Chief Executive Officer wrote to Debevoise & Plimpton: "We completely agree with the position that Debevoise has taken so far with respect to Tamaya." (Pl.'s Ex. 17).

c. *Analysis*

The Defendants' first contention with respect to their tortious interference counterclaim is that State Street improperly obstructed the proposed sale of Cosayach's assets to SQM by insisting that State Street's consent be secured. Under New York law, to establish tortious interference with a prospective contract a party must show: "(1) business relations with a third party; (2) the defendant's interference with those business relations; (3) that the defendant acted with the sole purpose of harming the plaintiff or used dishonest, unfair, or improper means; and (4) injury to the business relationship." *Astor Holdings, Inc. v. Roski,* No. 01 Civ.1905, 2002 WL 72936, at *19 (S.D.N.Y. Jan. 17, 2002)(Lynch, J.)(internal citations omitted).

The Defendants argue that Cosayach was not a Guarantor at the time of the proposed sale of its assets to SQM and therefore could not be required to secure State Street's consent. The issue, however, is not whether Cosayach was a Guarantor, but whether Cosayach was a "Restricted Subsidiary." As noted above, under the Credit Agreements, so long as it was in default, Inverraz was prohibited from selling the assets of any Restricted Subsidiary—a term which was defined to include any Chilean company of which Inverraz either directly or indirectly owned 75 % of the voting stock or held a 75 % financial interest. (Defs.' Exs. G & K § 10B).

At the hearing, Sims conceded that Cosayach was a Restricted Subsidiary of Inverraz. (Tr. 202 ("Cosayach first region was still a restricted subsidiary of Inverraz[,] with more than 95 percent of the ownership concentrated in Inverraz"), 234 ("Cosayach is a restricted subsidiary")). Moreover, Inverraz was unquestionably in default at the time of the proposed sale of Cosayach's assets to SQM. (*Id.* at 232). Consequently, State Street plainly had the right to insist that no sale of Cosayach's assets occur without its permission. State Street's insistence that Inverraz comply with its contractual obligations also obviously did not stem from an impermissible desire to hurt Inverraz, but, rather, was simply intended to protect its substantial financial investment.

Moreover, even if State Street did not have a contractual right to bar the sale, the Defendants' tortious interference claim with respect to SQM still would fail because there has been no showing that State Street's actions were the proximate cause of the Defendants' loss. As Sims admitted, "SQM was very clear from the first time they had the claim from [BONY] that this is the way it should be." (Tr. 223). It follows that the tortious interference that the Defendants seek to prove was not caused by State Street, but by BONY. *See Turk v. Angel,* 293 A.D.2d 284, 740 N.Y.S.2d 50, 51 (1st Dep't 2002)(claims for tortious interference properly dismissed where "plaintiffs would not be able to demonstrate that defendants' conduct was the proximate cause of their alleged loss").

The Defendants' tortious interference counterclaim arising out of State Street's dealings with Tamaya is no more meritorious. All that State Street is alleged to have done with respect to Tamaya is decline to lend its counsel's imprimatur to an apparent end run around the trust arrangement established by BONY with respect to Cosayach's international sales. The suggestion that the failure to give such assurances to a third party is somehow wrongful is particularly misplaced in light of Inverraz's contemporaneous observation that it fully agreed with the approach taken by State Street's counsel. (Pl.'s Ex. 17).

2. *Fraudulent or Negligent Misrepresentation*

The Defendants also allege that State Street made certain fraudulent or negligent misrepresentations in connection with its alleged tortious interference. In support of this counterclaim, the Defendants have proffered an affidavit in which Francisco avers, in conclusory fashion, that State Street made such misrepresentations. (Affidavit of Francisco Javier Errazuriz-Ovalle, sworn to on December 14, 2001, ¶ 79). Despite that conclusory assertion, the Defendants have failed to identify any actual misrepresentations made by State Street or its counsel. This, of course, precludes any finding that the Defendants have a meritorious negligent misrepresentation counterclaim. *See Simon v. Castello,* 172 F.R.D. 103, 105- 06 (S.D.N.Y.1997)(Batts, J.)(Fed.R.Civ.P. 9(b) is applicable to negligent misrepresentation claims; accordingly, complaint which did not attribute any misleading statement to a defendant failed to state claim for fraud and negligent misrepresentation).

3. *Good Faith and Fair Dealing*

The Defendants further allege that State Street somehow breached its implied contractual obligation of good faith and fair dealing through its conduct with respect to SQM and Tamaya. In that regard, New York law

> recognizes that "in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing."

Bank of New York v. Sasson, 786 F.Supp. 349, 353 (S.D.N.Y.1992)(Mukasey, J.) (quoting *Kirke La Shelle Co. v. Paul Armstrong Co.,* 263 N.Y. 79, 87, 188 N.E. 163 (1933)). However, "the implied covenant does not extend so far as to undermine a party's 'general right to act on its own interests in a way that may incidentally lessen' the other party's anticipated fruits from the contract." *M/A-COM Sec. Corp. v. Galesi,* 904 F.2d 134, 136 (2d Cir.1990)(per curiam)(quoting *Van Valkenburgh, Nooger & Neville, Inc. v. Hayden Publ'g Co.,* 30 N.Y.2d 34, 46 (1972)). Similarly, the implied covenant cannot prevent a party from exercising a right that it has specifically been accorded pursuant to the contract. *See Canpartners Invs. IV v. Alliance Gaming,* 981 F.Supp. 820, 824 (S.D.N.Y.1997) ("[I]t is axiomatic that an implied covenant must comport with the parties' intent and be consistent with the written provisions of the contract."). *Cf. Grand Light & Supply Co. v. Honeywell, Inc.,* 771 F.2d 672, 679 (2d Cir.1985) (UCC good faith provision may not be used to override explicit contractual provisions); *Corenswet, Inc. v. Amana Refrig. Inc.*, 594 F.2d 129, 138 (5th Cir.1979) (same).

In this case, the Defendants have adduced no evidence which indicates that State Street improperly denied Inverraz the fruits, or otherwise defeated the purpose, of any of the contracts among the parties. While Inverraz may have believed that State Street's approach was unreasonable, there has been no showing that State Street took any action contrary to the Credit Agreements or Guaranties. It follows that the Defendants have not established any breach of the implied covenant of good faith and fair dealing. *See Sasson,* 786 F.Supp. at 354 ("so long as the promisee is allowed to reap the benefits of the contract, the implied covenant of good faith does not require the promisor to take actions contrary to his own economic interest such as extending, or even renegotiating the possible extension of, a risky loan").

4. *Fiduciary Duty*

The Defendants further allege that State Street breached its fiduciary duty to Inverraz and the Guarantors. It is settled law, however, that a bank does not have a fiduciary duty to its borrowers. *See Aaron Ferer & Sons Ltd. v. Chase Manhattan Bank,* 731 F.2d 112, 122 (2d Cir.1984) (under New York law, "usual relationship of bank and customer is that of debtor and creditor" and bank owes no fiduciary duty to borrower); *In re W.T. Grant Co.*, 699 F.2d 599, 612 (2d Cir.1983); *Weinberger v. Kendrick,* 698 F.2d 61, 79 (2d Cir.1982) (Friendly, J.) ("it would be anomalous to require a lender to act as a fiduciary for interests on the opposite side of the negotiating table"); *Sec. Nat'l Bank v. DeSeguros,* 21 Misc.2d 158, 161, 190 N.Y.S.2d 820 (1959)(guarantors must "look out for themselves"). *See also Marine Midland Bank v. Smith,* 482 F.Supp. 1279, 1287 (S.D.N.Y.1979) (Sand, J.) (same).

Notwithstanding this established principle, the Defendants urge this Court to find that a fiduciary duty existed here on the basis of Judge Chin's decision in *Scott v. Dime Sav. Bank of New York, FSB,* 886 F.Supp. 1073 (S.D.N.Y.1995), *aff'd.,* 101 F.3d 107 (2d Cir.1996). In that case, the defendant bank's conduct went far beyond the usual creditor-debtor relationship. For example, the bank induced the plaintiffs to borrow twenty times more money than they originally intended, and to invest much of the loan proceeds through a brokerage firm which was a bank affiliate. *Id.* at 1075. Faced with evidence of this conduct, Judge Chin properly instructed the jury that, in "special circumstances . . . , a fiduciary relationship will arise between a bank and a customer if there is a confidence placed in the bank that gives it an advantage in dealing with the customer who is placing his trust in the bank." *Id.* at 1078 n.7. One such special circumstance was the fact that "dual employees" of the bank and its brokerage affiliate were advising the plaintiffs about their stock purchases. *See id.* at 1079 (noting that stockbrokers may owe fiduciary duties to their customers under New York law).

Unlike *Scott,* the Defendants in this case have failed to show any special circumstances which would suggest that a fiduciary relationship existed between State Street and the Defendants. Indeed, the Defendants are part of a substantial international enterprise and were represented by a multinational law firm during most, if not all, of their dealings with State Street. When parties to a commercial transaction deal at arms length, there is no basis to impute a fiduciary obligation in the manner that the Defendants now suggest. *See Greenberg v. Chrust,* 198 F.Supp.2d 578, 583 (S.D.N.Y.2002) (Sweet, J.) (collecting cases). The proposed fiduciary duty counterclaim therefore lacks any factual or legal basis.

5. *Failure to Fulfill Condition Precedent*

The Defendants next allege that State Street, having sold its entire beneficial interest in both the 1994 and 1996 loans, lacks standing to bring this lawsuit on behalf of the participants. More specifically, the Defendants contend that State Street failed to comply with a condition precedent in the Participation Agreements that required that the holders of more than 50 % of the participation interests agree, in writing, before any suit was filed. This contention is wrong on both the facts and the law. First, at the hearing, State Street introduced without objection two "Written Directions" which appear to have been signed by the requisite number of participants. (*See* Pl.'s Exs. 19, 20). Second, each of the Participation Agreements specifically provides that

> the understandings and agreements contained in this Agreement are solely for the benefit of [State Street] and the Participants and there are no other parties (including [Inverraz]) that are intended to be benefitted in any way or relieved of any obligations to [State Street] or any of the Participants.

(*Id.* ¶ 18). Thus, even if the participants had not previously agreed in writing to the institution of this action, the Defendants plainly are not third-party beneficiaries of the Participation Agreements, and cannot rely upon any alleged breach of them.

In an effort to suggest that they have standing to pursue this claim, the Defendants cite two lines of authority, neither of which is germane. The first consists of cases in which the plaintiff failed to comply with a contractual condition precedent before bringing suit against another party *to the same contract*. *See, e.g., Film-Line (Cross-County) Prods., Inc. v. United Artists Corp.*, 865 F.2d 513, 518 (2d Cir.1989) (contract between parties required notice of termination). The second group involves suits instituted by an individual trust beneficiary in violation of the trust agreement. *See, e.g., Allen v. Pierson,* 113 A.D. 586, 100 N.Y.S. 451 (4th Dep't 1906) (beneficiary could not maintain foreclosure action without participation of trustee or majority in amount of claim holders as trust agreement required). Here, in marked contrast to these cases, the Participation Agreements expressly state that the Defendants are not beneficiaries of the understandings between State Street and the participants. Accordingly, even if the Participation Agreements were violated, the Defendants lack any basis to complain.

6. *Improper Declaratory Language*

The Defendants also contend that the default judgment improperly restricts the assets of Compania de Salitre y Yodo de Chile S.A. ("Cosayach Chile"), a company that is not a party to this litigation.[8] (Defs.' Reply Mem. at 5-9). Insofar as relevant, the default judgment provides that, "under the terms of the 1994 [Credit] Agreement, the 1996 [Credit] Agreement, the 1994 Guaranty and the 1996 Guaranty, the *defendants* may not sell or transfer the assets of [Cosayach Chile] without plaintiff's prior consent." (Docket No. 38) (emphasis added). The Defendants' protestation that this language impermissibly restricts the rights of a nonparty misses the mark. By its express terms, the default judgment does not restrict Cosayach Chile in any respect. Rather, the only entities that are restricted from transferring any assets are the "[D]efendants."

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[8] Although Cosayach Chile appears to be a different entity than Cosayach, the parties have not explained the relationship between the two.

7. *Improper Guarantors*

The final "counterclaim" asserted by the Defendants is that certain of them are not in fact Guarantors of the Inverraz indebtedness. (Defs.' Reply Mem. at 10-15). There are two aspects to this claim. First, with respect to the 1996 Guaranty, the Defendants contend that Cosayach and Salmones are not Guarantors. (*Id.* at 13; Tr. 182). Second, the Defendants contend that certain new entities created through tax-motivated transactions, known in Chile as ecisones, are not Guarantors. (Defs.' Reply Mem. at 10-11; Tr. 256-57).

The argument that Cosayach and Salmones are not Guarantors proceeds on the mistaken assumption that the only companies that should be deemed Guarantors on any given Liability Calculation Date are those that are necessary to ensure that Inverraz's indebtedness under the 1996 Credit Agreement is guaranteed by 90 % of the Consolidated Total Assets of all of the Eligible Subsidiaries. Under paragraphs 5L and 10B of the 1996 Credit Agreement, in addition to the Original Guarantors, each Inverraz subsidiary that qualified as an Eligible Material Subsidiary as of a Liability Calculation Date became an additional Guarantor. The 1996 Credit Agreement, by which each Guarantor of the 1996 loan agreed to be bound, defined the term "Eligible Material Subsidiary" to include any Inverraz subsidiary which held more than 5 % of the Consolidated Total Assets of all of the Eligible Subsidiaries. Thus, any Eligible Material Subsidiary is necessarily a Guarantor. Moreover, the 1996 Guaranty mandated that any Eligible Subsidiary required to serve as a Guarantor would become a party to the Guaranty. (Defs.' Ex. F ¶ 26).

At the hearing, Sims presented Inverraz's differing interpretation of the relevant loan documentation. He suggested, in substance, that the 1996 Credit Agreement and Guaranty together provided that only those Eligible Subsidiaries needed to ensure that Guarantors collectively held 90 % of the Consolidated Total Assets of all of the Eligible Subsidiaries were required to serve as Guarantors as of any Liability Calculation Date. (Tr. 177, 183; Pl.'s Ex. 13). Thus, if Inverraz's largest Eligible Subsidiary held 90 % of the Eligible Subsidiaries' Consolidated Total Assets on a Liability Calculation Date, only that subsidiary would be required as a Guarantor. (*Id.* at 183). On the other hand, if the largest Eligible Subsidiary held less than 90 % of those assets, other Eligible Subsidiaries would have to be added to the list of Guarantors—from the largest to the smallest—until the 90 % threshold was met.

In support of this reading, the Defendants pointed to a schedule submitted to State Street in February 2000. (*See* Pl.'s Ex. 12). By means of that schedule, Inverraz had represented to State Street, without objection, that the only Guarantors under the 1996 Guaranty as of that date were four Eligible Subsidiaries that held 90 % of the Consolidated Total Assets of all of the Eligible Subsidiaries. The schedule indicated as follows:

Eligible Subsidiary	**Percentage of Consolidated Total Assets**
Supermercados Unimarc S.A.	37.2%
Cidef S.A.	27.2%
Cidef Argentina S.A.	16.3%
Pesquera Nacional S.A.	15.0%
Cosayach 1st Region	11.4%
Salmones	5.5%

(*Id.* Sched. I). As State Street accurately points out, Inverraz's calculations appear to be incorrect on their face because the allocable percentages suggested for the six Eligible Subsidiaries total 112.6 %.[9]

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[9] According to documents submitted by State Street at oral argument, the correct figures are: Supermercados, 29.85 %; Cidef, 21.88 %; Cidef Argentina, 13.11 %; Pesquera Nacional, 12.06 %; Cosayach, 9.13 %; and Salmones, 4.43 %.

Based upon its calculations, Inverraz identified the Guarantors under the 1996 Guaranty and their Attributable Liability as of January 1, 2000 as follows:

Guarantor	**Attributable Liability (U.S. $)**
Supermercados Unimarc S.A.	25,230,328
Cidef S.A.	18,494,155
Cidef Argentina S.A.	11,081,729
Pesquera Nacional S.A.	10,193,788

(Pl.'s Ex. 12 at 1).

In advancing the argument that only the four "above-the-line" Eligible Subsidiaries were Guarantors as of January 1, 2000, the Defendants overlook the fact that, by their own calculations, all six of the Eligible Subsidiaries on Inverraz's schedule held more than 5 % of the Consolidated Total Assets of the Eligible Subsidiaries and therefore qualified as Eligible Material Subsidiaries. As such, pursuant to Paragraph 5L(a) of the 1996 Credit Agreement, all six entities were necessarily Guarantors of the 1996 indebtedness, irrespective of the 90 % threshold.[10]

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[10] If the Court were to adopt State Street's alternative calculations, Salmones would not qualify as an Eligible Material Subsidiary because it held only 4.43 % of the Consolidated Total Assets. Under those calculations, however, the five largest Eligible

(Cont'd)

Turning to the Defendants' other "Guarantor" argument, it is undisputed that three Inverraz subsidiaries engaged in ecisones under Chilean law. An ecison is a transaction pursuant to which one company is divided into two, with the original company retaining its own name and most of the corporate assets and liabilities. (Tr. 245). As part of the process, the original company's tax losses are transferred to the new entity. (*Id.* at 245-46). Although both the original company and the new company remain liable for any preexisting obligations, (*id.* at 253), the ecison creates an opportunity for the transferee of the tax losses to merge with another more profitable company to lower the tax burden of the latter company. (*Id.* at 245-46).

The evidence at the hearing indicates that Inverraz engaged in the following ecisones:

Old Company	**New Company**	**Date**
Pesquera Nacional S.A.	Inversion Nacional S.A [11]	2/16/98
Salmones Unimarc S.A.	Inversiones Unimarc S.A	4/30/98

(Cont'd)

Subsidiaries collectively held only 86.03 % of the Consolidated Total Assets of the Eligible Subsidiaries. Under the 1996 Credit Agreement, State Street therefore was entitled to look to the next largest Eligible Subsidiary—Salmones—as a Guarantor to ensure that the loan was secured by Guarantors holding 90 % of the Consolidated Total Assets of all of the Eligible Subsidiaries.

[11] Inversion Nacional S.A. later changed its name to Unimarc Abastecimientos S.A.

Industria Forestal Nacional S.A.	Forestal Regional S.A.	1/19/98
Cidef S.A.	Corporacion de Inversiones y Desarrollo Financiero Cidef S.A.	7/4/00

(Tr. 246-50; Pl.'s Exs. 22, 23, 25, 26).

The Defendants contend that the new companies created by the ecisones are not proper Guarantors because State Street orally agreed to look only to the original companies as a repayment source. With respect to this alleged arrangement, Sims testified as follows:

> Q Well, do you know whether the lenders were informed of the ecis[]on and given a representation that the new entities would remain liable for the obligations of the old entities?
>
> A They were informed that they had the option, according to the Chilean law and according to the document that establishes the ecis[]on, . . . also to have as guarantors both companies that will come out of this division. But they also knew that one of these two companies were just tax losses, since there had been changes in the tax ID number . . . the lenders opted so there should

be shareholders meetings of these new companies ratifying the previous guarantees.

Q Both new companies?

A . . . [N]o, not both companies, the real company, not—they didn't want the other one. The real company, the big one, the company that owned the asset not the taxes.

* * *

Q Do you have any communications to the lenders reflecting that they opted for one company versus both companies?

A I don't know. I don't remember exactly. That was many years ago, but I know that we talked with them, and we made the shareholder meeting and we send them everything.

(Tr. 256-57). Apart from this testimony, Inverraz provided no details whatsoever concerning this alleged understanding between the Defendants and State Street.

Paragraph 21 of each Guaranty states, in part, that "[a]ll covenants and other agreements herein by or on behalf of each Guarantor shall bind its successors, whether so expressed or not." Similarly, Paragraph 25 of each Guaranty states that the Guaranty may not be amended without State Street's "written consent." In light of these contractual protections, and having observed the witnesses who testified at the hearing, I do not credit the Defendants' unsupported suggestion that State Street orally agreed not to hold the new companies resulting from the ecisones liable as Guarantors. Moreover, even if some State Street officer did make a statement to that effect, Paragraph 25 of the Guaranty establishes that the Defendants could not reasonably rely on it in the absence of an appropriate writing.

In sum, there is no basis for either of the arguments advanced by the Defendants regarding the proper Guarantors.

C. *Prejudice*

The Defendants' failure to prove a meritorious defense alone dictates that the default judgment must remain in place. *Nat'l Union Fire Ins. Co. v. Allard*, No. 87 Civ. 5368, 1989 WL 71168, at *1 (S.D.N.Y.1989) ("Before a default judgment will be vacated, [the defendant] must demonstrate a meritorious defense to the complaint."); 12 James Wm. Moore, et al., *Moore's Federal Practice*, ¶ 60.24[1] ("A precondition of relief from judgment is that the movant show that he or she has a meritorious defense."). Nevertheless, because the issue of prejudice was also referred to me, I have considered whether State Street would suffer an impermissible level of prejudice if the default judgment were vacated.

The delay in enforcement resulting from the vacatur of a default judgment does not, by itself, give rise to an impermissible level of prejudice. Instead, "it must be shown that delay will result in the loss of evidence, create increased difficulties in discovery, or *provide greater opportunity for fraud or collusion.*" *Davis*, 713 F.2d at 916 (quoting 10 Charles Alan Wright, et al., *Federal Practice and Procedure*, ¶ 2699, at 536-537) (emphasis added).

At the Defendants' request, prior to the evidentiary hearing, I required State Street to detail in an interrogatory answer how it would be prejudiced by a vacatur of the default judgment. In its response, State Street identified a lengthy series of allegedly improper transactions involving Cosayach and its subsidiaries. (*See* Defs.' Ex. O). At the evidentiary hearing, Sims conceded that each of these transactions had in fact occurred after Inverraz defaulted on its loan payments in or around April 2000.[12] (Tr. 232). Sims nevertheless maintained that none of the transactions violated the Credit Agreements. (*Id.* at 227). As shown previously, however, because Cosayach was a Restricted Subsidiary, each of these post-default transactions unquestionably violated the terms of the Credit Agreements.

Several of the transactions identified by State Street are particularly troubling. As the Defendants conceded at the hearing, shortly after Inverraz missed its November 2000 loan payment, Cosayach and three of its subsidiaries transferred control of certain of their assets to Holandaus, an entity not part of the Inverraz group in which the Senator has some unspecified financial interest. (Tr. 237-39). The Cosayach subsidiaries that sold the assets all were Restricted Subsidiaries, (*id.* at 240), which were prohibited from effecting such transfers without State Street's consent while Inverraz was in default. Among the assets sold were two chemical plants and some mining properties. (*Id.* at 238). It is clear that these were not inconsequential transactions since Sims admitted that the assets conveyed represented approximately 20-30 % of Cosayach's total assets. (*Id.* at 239).

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[12] Although Inverraz had failed to make required loan payments as early as March 1999, State Street had agreed to defer the payments that were due that year. (Tr. 230-31).

Subsequently, in the fall of 2001, Holandaus reconveyed these same assets to the Cosayach subsidiaries. (*Id.* at 241). In late October 2001, however, the three subsidiaries issued stock to Holandaus which gave Holandaus a controlling interest in all three subsidiaries. (*Id.* at 241); *see also* Ex. O at 4 (Int.Nos. 4(s)-(u)). Although Francisco described this odd series of transactions as an exchange of debt for equity which redounded to the benefit of Inverraz and Cosayach, (Tr. at 318-19), the fact remains that substantial assets of Cosayach were transferred out of the Inverraz group in violation of the Credit Agreements and without State Street's consent. (*See id.* at 239, 322). Moreover, those assets are now located in a company affiliated with the Senator.

Following the evidentiary hearing, State Street submitted a letter to the Court suggesting that Inverraz's misconduct with respect to its subsidiaries' assets was continuing. (*See* letter from Joseph P. Moodhe, Esq., to the Court, dated July 17, 2002, at 2) (alleging, *inter alia,* that control of another Cosayach subsidiary's assets was effectively transferred to Holandaus just weeks after the hearing). State Street subsequently indicated, however, that it "was requesting the Court to re-open the record only if the Court was inclined . . . to recommend granting the [Defendants'] motion." (*See* letter from Mr. Moodhe to the Court, dated July 22, 2002).

In response to the first letter from State Street's counsel, the Defendants objected to the Court's consideration of any of State Street's new allegations without affording the Defendants "a reasonable period of time to present appropriate evidence, which, I am advised, will refute and discredit the plaintiff's assertions." (*See* letter from Michael E. Wolk, Esq., to the Court, dated July 18, 2002 ("Wolk 7/18 Letter"), at 1)(block capitalization deleted). The Defendants also argued that State Street was trying to have "all [the] Chilean entities . . . conveniently 'lumped together' . . . , regardless of whether such Chilean entities signed the contracts which are the subject of this lawsuit, or otherwise have any monetary obligations to [State Street]." (*Id.* at 4). Despite their request for additional time, the Defendants have never responded to the substance of State Street's accusations regarding these additional transactions.

It is not necessary to address State Street's post-hearing allegations in order to resolve the question of potential prejudice to State Street. The July 18th letter from Mr. Wolk contends that there is a "fierce factual and legal dispute" as to whether Cosayach is a Guarantor or Restricted Subsidiary and, even if it is, can be bound by loan documentation that it never signed. (*Id.* at 2). As Mr. Wolk notes, "*[i]f* [Cosayach] is not a Guarantor—or if that issue cannot be conclusively determined on the Record to date—then there is no 'impermissible level of prejudice' to [State Street], on the vacatur motion, from any transactions involving [Cosayach]." (*Id.*) (emphasis added). As noted earlier, however, Cosayach *is* a Restricted Subsidiary, and the transactions that it undertook with Holandaus consequently are clear violations of the restrictive covenants set forth in the 1996 Credit Agreement. Since the Defendants continue to ignore the plain language of their agreements, as well as the negative covenants designed to protect State Street's investment, there obviously is a substantial risk that such impermissible transactions will continue in the future if the default judgment is vacated. Accordingly the Defendants have not met their burden of establishing a lack of prejudice. *See ARA Serv., Inc. v. Olympia Vending & Amusement Corp.*, No. 88 Civ. 41733, 1990 WL 41733, at *2 (S.D.N.Y. Apr. 4, 1990)(Lowe, J.)(judgment not vacated where defendant had, among other actions, transferred assets to a related corporation in violation of parties' agreement); *SDI Capital Resources v. 48-50 9th Operating, Inc.*, No. 98 Civ. 3784, 1998 WL 512961, at *2 (S.D.N.Y. Aug. 18, 1998)(Martin, J.)(finding prejudice where plaintiff alleged that defendant had begun to remove assets from the state).

V. *Conclusion*

In sum, even though the Defendants' default was not wilful, they have failed to establish a meritorious defense or counterclaim or that State Street would not be prejudiced. Accordingly, the Defendants' motion to vacate the default judgment should be denied.

VI. *Notice of Procedure for Filing of Objections to this Report and Recommendation*

The parties are hereby directed that if they have objections to this Report and Recommendation, they must, within ten days from today, make them in writing, file them with the Clerk of the Court, and send copies to the chambers of the Honorable Robert L. Carter, at the United States Courthouse, 500 Pearl Street, New York, New York 10007, to the chambers of the undersigned, at the United States Courthouse, 500 Pearl Street, New York, New York 10007, and to any opposing parties. *See* 28 U.S.C. § 636(b)(1); Fed.R.Civ.P. 6(a), 6(e), 72(b). Any requests for an extension of time for filing objections must be directed to Judge Carter. The failure to file timely objections will result in a waiver of those objections for purposes of appeal. *See Thomas*

v. Arn, 474 U.S. 140, 106 S.Ct. 466, 88 L.Ed.2d 435 (1985); *Frank v. Johnson,* 968 F.2d 298, 300 (2d Cir.1992); 28 U.S.C. § 636(b)(1); Fed.R.Civ.P. 6(a), 6(e), 72(b).

Dated: New York, New York
August 15, 2002

s/ Frank Maas
FRANK MAAS
United States Magistrate Judge

APPENDIX E — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED MARCH 6, 2002

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

01 Civ. 3201 (RLC) (FM)

STATE STREET BANK AND TRUST CO.,

Plaintiff,

-against-

INVERSIONES ERRAZURIZ LIMITADA, et al.,

Defendants.

FRANK MAAS, United States Magistrate Judge.

Pursuant to a conference held yesterday, it is hereby ORDERED that:

1. Within one week, the plaintiff shall serve the defendants with an interrogatory intended to elicit further details regarding the defendants' contention that they reasonably believed that they were being represented by Gibson, Dunn & Crutcher ("Gibson, Dunn") in connection with this litigation in or after September 2001.

2. The defendants shall respond to said interrogatory within two weeks after it is served.

3. Within two weeks thereafter, no more than three Gibson, Dunn attorneys whose statements are relied on by the defendants may be deposed. If necessary, a Rule 30(b)(6) witness designated by Gibson, Dunn also may be deposed. If Gibson, Dunn designates one of the other deponents as its Rule 30(b)(6) witness, only one deposition of that witness shall be taken.

4. Within one week, the defendants shall serve the plaintiff with an interrogatory intended to elicit further details regarding the specific prejudice that plaintiff alleges it will suffer if the default judgement is vacated.

5. The plaintiff shall respond to said interrogatory within two weeks after it is served.

6. On or before April 12, 2002:

    (a) the defendants shall furnish the Court with any necessary further details concerning their counterclaims;

    (b) both sides shall submit to the Court any further affidavits, exhibits, or memoranda; and

    (c) the defendants shall identify any evidence in the exclusive possession of third parties that they contend is relevant to their counterclaims and explain why it is relevant.

7. The Court will conduct an evidentiary hearing regarding the defendants' application to vacate the default judgment commencing at 10:00 a.m. on April __, 2002, in Courtroom 11C.

SO ORDERED.

Dated: New York, New York
March 6, 2002

s/ Frank Maas
FRANK MAAS
United States Magistrate Judge

APPENDIX F — OPINION OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED FEBRUARY 4, 2002

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

No. 01 CIV. 3201(RLC)

STATE STREET BANK AND TRUST COMPANY,

Plaintiff,

-against-

INVERSIONES ERRAZURIZ, LIMITADA (f/k/a INVERSIONES ERRAZURIZ S.A.), SUPERMERCADOS UNIMARC S.A. (f/k/a COMMERCIAL E INMOBILIARIA UNIMARC S.A.), PESQUERA NACIONAL S.A., UNIMARC ABASTECIMIENTOS S.A., CIDEF S.A., SALMONES UNIMARC S.A., INDUSTRIA FORESTAL REGIONAL S.A., CIDEF ARGENTINA S.A., CORPORACIN DE INVERSIONES Y DESARROLLO FINANCIERO CIDEF S.A., and SOCIEDAD CONTRACTUAL MINERA COMPAIA DE SALITRE Y YODO PRIMERA REGIN (f/k/a COMPAIA DE SALITRE Y YODO PRIMERA PRIMERA REGIN S.A.),

Defendants.

Appendix F

OPINION

ROBERT L. CARTER, District Judge.

Defendants Inversiones Errazuriz Limitada, et al., move, pursuant to F.R. Civ. P. 55(c) and 60(b), to vacate the $140 million default judgment entered against them by this court on November 21, 2001. Plaintiff State Street Bank and Trust Company opposes the motion. For the reasons set forth below, defendants' motion to vacate is denied for the time being. However, certain issues pertaining to the willfulness of the default, the merits of specific defenses advanced by defendants, and the level of prejudice plaintiff would experience if the default judgment were vacated are referred to Magistrate Judge Frank Maas for further inquiry.

BACKGROUND

On April 16, 2001, plaintiff filed suit against defendants, in this court, seeking to recover over $100 million owed to plaintiff pursuant to two Credit Agreements executed in 1994 and 1996, respectively. (Compl.¶ 1.) Defendants did not answer the complaint but, for several months thereafter, the parties engaged in ongoing settlement negotiations. In late June of that year, the parties even signed a stipulation extending the time to answer and acknowledging personal jurisdiction and service of process. The stipulation expired, but still the talks continued. Then, on September 28, 2001, plaintiff broke off negotiations and filed a motion for default judgment. Plaintiff requested, and received, an entry of default. The deadline to reply came and went with no word from defendants. On November 30, 2001, this court granted plaintiff's motion, entering default judgment against defendants for approximately $140 million dollars. Finally, on December 19, 2001, defendants reappeared, filing a motion to vacate the substantial default judgment entered against them. Plaintiff opposed, bringing events to where they now stand.

DISCUSSION

Since a default judgment is already in place in this case, F.R. Civ. P. 55(c) requires that defendants' motion to vacate be reviewed in accordance with the standards set forth in F.R. Civ. P. 60(b).[1] Defendants argue that this case falls under the provision of F.R. Civ. P. 60(b), which states that a default judgment may be set aside for reason of "mistake, inadvertence, surprise, or excusable neglect." In assessing a claim of excusable neglect, courts typically make three inquiries: "(1) whether the default was willful; (2) whether defendant has a meritorious defense; and (3) the level of prejudice that may occur to the non-defaulting party if relief is granted." *Am. Alliance Ins. Co., Ltd. v. Eagle Ins. Co.*, 92 F.3d 57, 59 (2d Cir.1993) (quoting *Davis v. Musler,* 713 F.2d 907, 915 (2d Cir.1983)).

Because it is defendants who move to vacate, they bear the burden of demonstrating that their default was not willful, that they have meritorious defenses, and that no prejudice would result from reopening the judgment. *See Sony Corp. v. Elm State Electronics, Inc.*, 800 F.2d 317, 320 (2d Cir.1986) (citing 10 Wright, Miller & Kane, *Federal Practice and Procedure* Civil 2d § 2693 at 478). This burden is not trivial: if the moving party fails to make even one of the three aforementioned showings, vacatur should be denied. *See Barnes v. Printron, Inc.*, No. 93 Civ. 5085, 1999 WL 335362, at *3 (S.D.N.Y. May 25, 1999) (Keenan, J.) ("[A] finding of willfulness obviates the need to continue the inquiry with respect [to] the existence of a meritorious defense and prejudice.").

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[1] F.R. Civ. P. 55(c) states: "For good cause shown the court may set aside an entry of default and, if a judgment by default has been entered, may likewise set it aside in accordance with Rule 60(b)."

Defendants' burden, however, is also eased somewhat by the countervailing consideration that "[s]trong public policy favors resolving disputes on the merits." *Am. Alliance Ins. Co., Ltd.*, 92 F.3d at 61; *see also Cody v. Mello,* 59 F.3d 13, 15 (2d Cir.1995) (collecting cases that demonstrate this Circuit's clear "preference that litigation disputes be resolved on the merits, not by default"). Given this strong preference, courts often resolve reasonable "doubts in favor of the party seeking relief from judgment to facilitate resolution of disputes on their merits." *Barnes,* 1999 WL 335362, at *3 (quoting *Corchia v. Metropolitan Life Ins. Co.,* No. 94 CIV. 7058, 1996 WL 18953, at *1 (S.D.N.Y. Jan.17, 1996) (Keenan, J.)); *see also Pecarsky v. Galaxiworld.com Ltd.*, 249 F.3d 167, 172 (2d Cir.2001). The presumption against default is particularly strong where, as here, substantial sums of money are demanded. *See Sony Corp.,* 800 F.2d at 320 (listing cases that suggest default is disfavored where large sums of money are involved).

A. Willfulness

The first inquiry this court must make in assessing defendants' claim of excusable neglect is whether their default was willful. Mere negligence, even if gross, does not necessarily rise to the level of willful default. *See Am. Alliance,* 92 F.3d at 60, 61. However, no showing of bad faith on the part of the defaulting litigants is necessary to deny relief. *Gucci,* 158 F.3d at 635. And it is well settled that a default judgment should not be vacated "where the moving party ha[s] apparently made a strategic decision to default." *Am. Alliance,* 92 F.3d at 60 (citations omitted).

In this case, defendants deny that their default was deliberate or even grossly negligent. They claim their failure to respond to plaintiff's motion was the result of an erroneous belief that Gibson Dunn & Crutcher ("Gibson Dunn"), the firm that had represented them in settlement negotiations with plaintiff, would serve as their litigation counsel as well. (*See* Defs.' Mem. at 96.) Defendants insist that, when Gibson Dunn declined to do so, they were caught completely by surprise. Their allegedly unexpected abandonment forced defendants to quest for new counsel at precisely the time they otherwise would have been opposing plaintiff's motion for default. *See Id.* To make matters worse, the first firm defendants enlisted to take over their defense, Thacher Proffitt & Wood, had to withdraw almost immediately because of a potential conflict of interest. *Id.* at 93. As a result, defendants claim they were forced yet again, through no fault of their own, to search for substitute counsel. Finally, in early November, defendants found their man in Michael B. Wolk, the attorney who represents them in the instant action. (Wolk Aff.) Mr. Wolk promptly contacted the court with news of his retainer and set about producing the massive motion to vacate filed by defendants on December 19th. By this time, however, it had been some two weeks since this court granted plaintiff's request for default judgment, and nearly three months since plaintiff first filed for the same.

While on the subject of Mr. Wolk, the court feels compelled to add a few words admonishing his conduct thus far in this case. Mr. Wolk has repeatedly tried the court's patience, submitting his initial motion late,[2] refusing to file said motion in the form ordered by the court,[3] and disrupting a court-sanctioned deposition, just to mention a few examples of his obstinate behavior. The court is mindful that Mr. Wolk has labored under difficult circumstances. However, so many of his problems have been self-imposed, the result of his inability to follow the court's clear directions.[4] Mr. Wolk is strongly advised to pay closer heed in all future interactions with the magistrate judge and this court.

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[2] The default judgment was entered on November 30th, so the automatic 10-day stay on enforcement, pursuant to F.R. Civ. P. 62(a), expired on Friday, December 14th. Mr. Wolk submitted his motion, in an incorrect form, the following Monday, December 17th. It was not until Wednesday, December 19th, that he submitted a motion to vacate, as ordered by the court.

[3] Mr. Wolk was told quite clearly that, if he wished to challenge the default judgment against defendants, he should bring a motion to vacate. Instead, he insisted upon filing an order to show cause.

[4] For example, if Mr. Wolk had followed directions and filed a motion to vacate, his submission likely would not have been tardy.

Returning to the matter at hand, plaintiff predictably contests defendants' benign description of events, characterizing their default as a deliberate tactical decision designed to "buy time before being subject to a judgment . . . to which they have no defense." (Pl.'s Opp'n Mem. at 8.) In support of this troubling indictment, plaintiff offers the deposition of Connor Reilly, a Gibson Dunn attorney who represented defendants during their abortive settlement negotiations with plaintiff. At first glance, Mr. Reilly's statements seem to seal the case against defendants. Particularly problematic for their account is Mr. Reilly's testimony that, as early as April 2001, he had informed defendants that his firm would not represent them in this action, and that they should seek and retain separate trial counsel. *Id.* at 5 (citing Reilly Dep. at 58-59). Plaintiff takes pains to emphasize this point, along with Mr. Reilly's assertion that he repeatedly reminded defendants, both before and after June 2001, that the time to respond to plaintiff's complaint had expired. *Id.* (citing Reilly Dep. at 66-67).

In response, however, defendants counter with relevant evidence that resuscitates their claims. They offer detailed billing records and e-mails that establish Mr. Reilly was only one of several Gibson Dunn attorneys who worked on behalf of defendants, and that he was not even the senior partner in charge of defendants' account. (Defs.' Reply Mem. at 23 (citing Defs.' Reply Affs. and Ex. B thereto).) These points are probative because they raise the possibility that other attorneys at Gibson Dunn besides Mr. Reilly may have promised defendants the firm's litigation services, just as defendants say occurred. The aforementioned records also show that Gibson Dunn billed defendants specifically for litigation-related services on a number of occasions. Much of this litigation work was performed well after Mr. Reilly says he first informed defendants they should retain new litigation counsel. The work apparently even stretched into the immediate aftermath of September 27th, when plaintiffs served notice of their intention to seek a default judgment.[5]

Finally, defendants also provide a copy of a receipt indicating that, on October 10th, shortly after plaintiff filed for default judgment, defendants wired $200,000 to Gibson Dunn. Defendants say that shortly thereafter, Gibson Dunn abruptly severed all ties with them. While the foregoing evidence does not establish the existence of an agreement between defendants and Gibson Dunn, it does tend to corroborate defendants' good faith (if erroneous) expectation that Gibson Dunn would continue to represent their interests in litigation against plaintiff. There is thus some possibility that this erroneous expectation, coupled with their attendant inability to find a new representation, were what led to their default. If defendants were to prove that the foregoing is really what happened, this case would be substantially similar to *Pecarsky v. Galaxiworld.com Ltd.*, 249 F.3d 167, 172 (2d Cir.2001) (finding that a defendant's default was not willful where its failure to appear was the result of an inability to obtain new counsel after its attorneys withdrew from the case).[6]

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[5] A representative selection from shortly after plaintiff moved for default judgment reads:

> 10/11/01
>
> 5.50 Franklin, Blake T: Teleconferences with C.D. Reilly, J.M. Trujillo regarding appearance in court; meeting with C.D. Reilly, M. Karlan to go over defenses, strategy. . . .

Similar entries refer explicitly to "Litigation." Defendants, of course, claim that Mr. Franklin (not Mr. Reilly) was the partner in charge of the matter.

However, defendants have not, as yet, convinced the court that their default was not willful. What they have done is raise a number of questions and concerns that merit further inquiry. Given this uncertainty, the prudent solution is "to have each side make an evidentiary presentation before a magistrate and have the magistrate decide" whether the default was willful or not. *Ferraro v. Kuznetz,* 131 F.R.D. 414, 420 (S.D.N.Y.1990). Such a hearing is consistent with Rule 55(b)(2), which states:

> If, in order to enable the court to enter a judgment or to carry it into effect, it is necessary to determine the amount of damages or to establish the truth of any averment by evidence or to make an investigation of any other matter, the court may

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[6] *Pecarsky* technically involved a direct appeal of the entry of a default judgment, rather than a motion to vacate like that in this case. However, the *Pecarsky* court made it clear that a default judgment (as opposed to mere entry of default) was at issue, and it reviewed the district court's decision accordingly. *See Pecarsky,* 249 F.3d at 171 ("[O]ur review of the district court's decision to grant the default judgment will examine the willfulness of default, the existence of a meritorious defense, and the possibility of prejudice to the plaintiffs should the default judgment be vacated.")

> conduct such hearings or order such references as it deems necessary and proper and shall accord a right of trial by jury to the parties when and as required by any statute of the United States.

F.R. Civ. P. 55(b)(2). Defendants must offer more proof than they have done thus far if they wish to convince the court that their default was not willful. However, they insist that they can, and will thus have an opportunity to do so before the magistrate judge.

B. Meritorious Defenses

The court next addresses the question of whether defendants have offered potentially meritorious defenses. To qualify as meritorious, a "defense need not be ultimately persuasive at this stage. A defense is meritorious if it is good at law so as to give the factfinder some determination to make." *Am. Alliance Ins. Co., Ltd.*, 92 F.3d at 61.

1. Forum Non Conveniens

The most obvious candidate for a meritorious defense is defendants' claim that this case should be dismissed on grounds of forum non conveniens.[7] Pursuant to the United

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[7] Defendants actually portray their forum non conveniens argument as a "threshold jurisdictional" issue, arguing that even if this court has jurisdiction over the dispute, "the federal application of forum doctrine *precludes* the Court from exercising that jurisdiction." (Defs.' Mem. at 7 (emphasis in original).) However, the doctrine is clearly a discretionary one. *See, e.g., Wiwa v. Royal*

(Cont'd)

States Supreme Court's decisions in *Gulf Oil Corp. v. Gilbert,* 330 U.S. 501 (1947) and *Koster v. American Lumbermens Mut. Cas. Co.,* 330 U.S. 518 (1947), courts confronted with a claim of forum non conveniens apply a two-step inquiry. The first step is to determine if an adequate alternative forum exists. *See, e.g., Piper Aircraft Co. v. Reyno,* 454 U.S. 235, 254 n. 22 (1981); *Gilbert,* 330 U.S. at 506-07, 67 S.Ct. 839. If one does, courts must then balance a series of public and private factors to decide which of the competing fora is more appropriate for resolution of the dispute. *See, e.g., Gilbert,* 330 U.S. at 508-09. The defendant bears the burden of establishing both that an adequate alternative forum exists and that the pertinent factors "tilt [ ] strongly in favor of trial in the foreign forum." *R. Maganlal & Co. v. M.G. Chem. Co.,* 942 F.2d 164, 167 (2d Cir.1991). "The plaintiff's choice of forum should rarely be disturbed." *Gilbert,* 330 U.S. at 508.

(Cont'd)

Dutch Petroleum, Co., 226 F.3d 88, 100 (2d Cir.2000) ("[F]orum non conveniens is a discretionary device permitting a court in rare instances to dismiss a claim even if the court is a permissible venue with proper jurisdiction over the claim.") (quotations omitted). Moreover, forum non conveniens is a subset of venue, which courts have taken pains to distinguish from jurisdiction. *See, e.g., Neirbo Co. v. Bethlehem Shipbuilding Corp.,* 308 U.S. 165, 167-68; Wright, Miller & Cooper, *Federal Practice and Procedure* Jurisdiction 2d § 3828 ("Venue is sometimes confused with jurisdiction. This ought not happen, for the two concepts are quite different."). Thus defendants' claim does not raise any jurisdictional issue, and is instead properly considered as part of the inquiry into whether they have raised a meritorious defense.

In this case, plaintiff does not challenge the adequacy of the alternative forum in Chile. Thus the real question is which forum do the public and private factors favor, bearing in mind the proper deference to plaintiff's preference for New York. Regarding this latter issue, defendants urge the court to accord "very slight, if any" deference in light of the Second Circuit's recent decision in *Irragorri v. United Tech. Corp.*, 274 F.3d 65 (2d Cir.2001). (Defs.' Mem. at 27.) According to defendant, *Irragorri* stands for the proposition that courts should "not accord any significant deference to an American plaintiff who sues in a federal district which is *outside* the district in which [the plaintiff resides]." *Id.* at 25-26 (emphasis in original). Defendants further suggest that the decision of plaintiff, a Massachusetts company, to bring suit in the Southern District of New York may constitute prime facie evidence of forum shopping. *Id.* at 26.

However, defendants misapprehend the Second Circuit's holding in *Irragorri.* The *Irragorri* court expressly rejected the stance taken by defendants in this case. *Irragorri,* 274 F.3d at 73 ("It is not a correct understanding of the rule to accord deference only when the suit is brought in the plaintiff's home district."). In fact, the result in *Irragorri* was to overturn the decision of the district court, which had applied a rationale similar to defendants' in dismissing a lawsuit on grounds of forum non conveniens. In remanding the case for reconsideration, the Second Circuit stated: "We believe that the District Court in the case before us . . . did not accord appropriate deference to the plaintiff's chosen forum." *Id.* at 75.

This reading of *Irragorri* is consistent with other cases decided recently by the Second Circuit, and referenced in *Irragorri* with approval. *See, e.g., Wiwa v. Royal Dutch Petroleum Co.,* 226 F.3d 88, 103 (2d Cir.2000) ("The district court weighed against the plaintiffs that none of them were residents of the Southern District of New York but did not count in favor of their choice of a U.S. forum that two of them were residents of the United States. This was error."); *Guidi v. Inter-Continental Hotels Corp.,* 224 F.3d 142, 147 (2d Cir.2000) ("[I]n a forum non conveniens case involving a foreign court, the 'home forum' for the [U.S.] plaintiff is any federal district in the United States, not the particular district where the plaintiff lives.") (quotations omitted).

The whole point of these decisions is to place the burden upon the defendant to show that a plaintiff, who files suit outside his district of residence, is doing so for strategic reasons. Defendants offer no compelling evidence, beyond breathless and conclusory allegations of hostile juries and unfavorable legal regimes, to demonstrate that this particular plaintiff has engaged in the sort of forum shopping frowned upon by the Second Circuit.[8] What is more, defendants' analysis fails to account for the most obvious reason plaintiff filed suit in this District: the Credit Agreements, with their forum selection clauses, made it reasonable for plaintiff to believe that defendants would be more amenable to suit in New York than anywhere else. *See Irragorri,* 274 F.3d at 73

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[8] Indeed, the court notes that many of the factors cited by defendants, such as the high cost of travel to and from this country, apply equally in reverse. That is, moving this case to Chile would simply impose upon plaintiff precisely the same inconveniences that defendants decry in their motion.

("Where a U.S. resident leaves her home district to sue the defendant where the defendant has established itself and is thus amenable to suit, this would not ordinarily indicate a choice motivated by desire to impose tactical disadvantage on the defendant.").[9] In light of these considerations, the court finds that defendants have not met their burden of demonstrating that the presumption in favor of plaintiff's choice of forum should be diminished in this case.

The aforementioned forum selection clauses also have significance for a related but distinct dispute over whether the Credit Agreements confer exclusive or non-exclusive jurisdiction on New York courts. If it is the former, then defendants' forum non conveniens argument is defeated unless they can show "that trial will be so gravely difficult and inconvenient that [they] will for all practical purposes be deprived of [their] day in court." *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 18 (1972). If it is the latter, then the court must engage in the more forgiving, traditional weighing of the public and private factors set forth in *Gilbert* and its progeny. The difficulty is that there are two separate credit agreements in this case, each with its own forum selection clause. The 1994 Agreement contains language that is clearly exclusive,[10] while the 1996 Agreement clearly does not.[11] Not surprisingly, defendants view the permissive language of the 1996 Agreement as controlling, whereas plaintiff presents the exclusive wording of the 1994 Agreement as dispositive. Neither side adequately explains why their preferred interpretation of the agreements should prevail. However, the court need not resolve this discrepancy because, even under ordinary forum non conveniens analysis, defendants fail to establish that the balance of public and private interests tilt decisively toward the Chilean forum.

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[9] In fact, plaintiff's assumption proved correct. In June 2001, defendants signed a stipulation consenting to personal jurisdiction and service of process.

[10] The 1994 Agreement provides, in relevant part: "[Inverraz] hereby absolutely and irrevocably consents and submits to the *exclusive* jurisdiction of the courts of the State of New York and of any federal court located in said jurisdiction. . . ." (emphasis added).

First, the private interest factors do not clearly favor defendants' choice of forum. These private factors include "the relative ease of access to sources of proof; availability of compulsory process for attendance of unwilling, and the cost of obtaining attendance of willing, witnesses . . . and all other practical problems that make trial of a case easy, expeditious and inexpensive." *Gilbert,* 330 U.S. at 508. Consideration of these concerns necessarily involves "comparison between the hardships defendant would suffer through the retention of jurisdiction and the hardships the plaintiff would suffer as the result of dismissal and the obligation to bring suit in another country." *Irragorri,* 274 F.3d at 74. In this case, the court cannot say that there would be any net reduction in hardship if this litigation were pursued in a Chilean court. As suggested previously, moving the litigation overseas would simply shift to plaintiff the very costs that defendants seek to avoid.

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[11] The 1996 Agreement provides, in relevant part: "[Inverraz] hereby absolutely and irrevocably consents and submits to the *non-exclusive* jurisdiction of the courts of the State of New York and of any federal court located in said jurisdiction. . . ." (emphasis added).

In fact, those costs would, if anything, be raised. Defendants' protestations notwithstanding, this case is, at its core, about their obligation to make payments to a United States bank account, as required by English language agreements, all of which were negotiated in New York. Much of the relevant evidence and many of the key witnesses are thus likely to be located in this country. As a result, requiring plaintiff to transport its witnesses and documents overseas would almost certainly be more expensive than requiring defendants to do the same.

This calculus remains substantially the same even if one factors in defendants' alleged counterclaims for tortious interference and breach of contract.[12] Defendants' insist that critical proof of these claims lies in Chile. However, their own affidavits indicate that "itemized details and evidence as to the Plaintiff's Unlawful Interference Conduct are contained in the files of [Gibson Dunn]," here in the United States. Errazuriz Aff. at ¶ 70. What is more, defendants allege, as part of their counterclaims, that plaintiff disrupted their business relationship with Tamaya Chemical. As plaintiff points out, however, "Tamaya is a U.S.-based company that was the U.S. distributor for defendants' iodine products." (Pl.'s Opp'n Mem. at 15 n. 7 (citing Reilly Dep. at Ex. 8).) Finally, defendants' assert that they would be constitutionally precluded from litigating these counterclaims in a United States federal court. But the case they cite in support of this contention, *Verlinden B.V. v. Central Bank of Nigeria*, 461 U.S. 480, 491-92 (1983), says nothing of the sort. Rather, *Verlinden* stands simply for the proposition that the diversity clause of Article III of the United States Constitution is not broad enough to permit federal court jurisdiction over claims by foreign plaintiffs against foreign sovereign defendants. Since all the parties in this action are private entities, the court clearly has diversity jurisdiction pursuant to 28 U.S.C. § 1332(a)(2).[13]

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[12] Defendants' counterclaims are discussed in greater detail in Part B.2, *infra*. Defendants make much of the fact that their counterclaims total some $200 million, exceeding plaintiff's damages by roughly $60 million. However, it is not at all clear how they reach that sum. As such these are just numbers, entitled to no legal weight.

Additionally, defendants have failed to demonstrate that the public interest factors favor litigation in the Chilean forum. The public interest most relevant to this dispute is the "appropriateness . . . in having the trial of a diversity case in a forum that is at home with the state law that must govern the case, rather than having a court in some other forum untangle problems in conflict of laws, and in law foreign to itself." Both the 1994 and 1996 Credit Agreements clearly state that they are to be "interpreted under and enforced in accordance with and governed by the laws of the state of New York without regard to principles of conflict of laws." And it is well settled that, "[a]s a general rule, choice of law provisions . . . are valid and enforceable in New York." *Marine Midland Bank, N.A. v. United Mo. Bank, N.A.*, 223 A.D.2d 119, 122-23, 643 N.Y.S.2d 528 (1st Dep't 1996) (citations omitted). Defendants have not given this court any reason to believe that their assent was procured by means of fraud or duress. The balance of public interest factors would thus seem to favor retention of this suit since a federal court in New York is in a much better position than its Chilean counterpart to construe applicable New York law in resolving plaintiff's claims.[14]

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[13] 28 U.S.C. § 1332(a)(2) states: "The district court shall have original jurisdiction of civil actions where the amount in controversy exceeds the sum or value of $75,000, exclusive of interest and costs, and is between . . . citizens of a State and citizens or subjects of a foreign state. . . ."

In sum, after weighing the relevant public and private interest factors, the court finds that defendants have failed to demonstrate that they have a meritorious defense pursuant to the doctrine of forum non conveniens. Even if plaintiff were not entitled to deference regarding its choice of forum, the court simply does not believe that the balance of conveniences in this case favors the Chilean forum.

2. Defendants' Counterclaims

As suggested previously, defendants advance a host of counterclaims, rooted in contract and tort law, arising out of plaintiff's allegedly bad faith and tortious conduct. First, defendants allege that plaintiff has impermissibly interfered with defendants' property, prior to a court judgment on the merits of their dispute, in violation of United States Supreme Court and New York State Court of Appeals precedent. (Defs.' Mem. at 107-11.) Second, defendants claim that plaintiff has engaged in activity that constitutes a breach of its implied obligation of good-faith and fair dealing under the Credit and Guaranty Agreements. *Id.* at 112. Third, defendants allege that plaintiff has engaged in knowing, intentional, and/or tortious interference with defendants' contractual relations, business operations, and prospective economic advantage. *Id.* at 113-16. Fourth, defendants accuse plaintiff of having made fraudulent and/or negligent misrepresentations regarding their rights under the Credit and Guaranty Agreements. *Id.* at 116-17. Fifth, defendants claim that plaintiff has breached its fiduciary duty owed under the Credit and Guaranty Agreements. *Id.* at 118-120. Sixth, defendants argue that plaintiff's suit against them is defective because it violates the conditions for bringing suit set forth in the Credit and Guaranty Agreements. *Id.* at 75. Seventh, defendants contend that the default judgment filed by plaintiff is defective because it contains a declaratory ruling that restricts the assets of a company that is not even a party to the lawsuit. (Defs.' Reply Mem. at 5-9.) Eighth and finally, defendants contend that the default judgment is defective because it awards damages against four defendants who are not guarantors under either the 1996 or 1994 Credit Agreements, and two other defendants who are not Guarantors under the 1996 Agreement. *Id.* at 10.

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[14] Defendants' purported counterclaims do not alter this conclusion. Most of these involve interpretation of the credit agreements, in one fashion or another. As a result, they too are governed by the New York choice of law provisions.

Plaintiff urges the court to reject all of defendants' counterclaims as invalid as a matter of law. Plaintiff offers two principal justifications for this result. The first is that defendants' counterclaims should be dismissed because they do not arise from the same transaction as that at the core of this case. (Pl.'s Opp'n Mem. at 18-21.) However, many of defendants' counterclaims seem to involve breaches of the very same Credit Agreements that plaintiff sues under. As such, they almost certainly do arise out of the same transaction, broadly defined. Plaintiff's other main argument is that defendants waived their right to interpose such counterclaims as a condition of both Credit Agreements. *Id.* at 21-22. However, New York law does not permit a party to invoke such waiver provisions to shield its malicious or fraudulent conduct. *See, e.g., Mfrs. Hanover Trust Co. v. Palmer Corp.,* 798 F.Supp. 161, 167 (S.D.N.Y.1992) (Haight, J.) ("[W]aivers [of defense] will not be enforced so as to bar a viable setoff or counterclaim sounding in fraud.") (quotations omitted).

Only the first of defendants counterclaims is so clearly invalid that the court is prepared to dismiss it out of hand. The cases cited by defendants, all of which deal simply with the limits on a *court's* equitable power to preliminarily enjoin a debtor's asset transfers, cannot serve as the basis for a viable counterclaim.[15] Accordingly, defendants' first counterclaim is dismissed. However, the factual record regarding defendants' seven remaining counterclaims is simply too incomplete for the court to conclude one way or the other whether they constitute meritorious defenses. These seven remaining counterclaims, like the question of the willfulness of defendants' default, are thus referred to the magistrate judge for further inquiry. After defendants have been given an opportunity to flesh out the factual foundation for each counterclaim, Magistrate Judge Maas will decide "whether the defendants possess a substantial meritorious defense, or whether the claims made in defendants' papers on these motions are just 'spurious.'" *Ferraro,* 131 F.R.D. at 420. Defendants insist that, given a meaningful opportunity, they can present compelling evidence of the viability of the seven remaining counterclaims.[16] Until they do, however, the default judgment stays in effect.

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[15] They do, however, tend to undermine the validity of plaintiff's application for a preliminary injunction or supersedeas bond pending resolution of this dispute. In any event, since the default judgment remains in effect, plaintiff's concerns are less pressing, and its request is denied. Should said judgment be vacated, of course, the court will reconsider its ruling.

C. Prejudice

A similar problem surrounds the third and final inquiry this court must make in reviewing a F.R. Civ. P. 60(c) motion to vacate on grounds of excusable neglect: whether plaintiff would suffer prejudice if the default judgment were vacated. Plaintiff argues that the prejudice here is "palpable" because "for more than one year defendants have been orchestrating a campaign to spirit assets beyond the reach of plaintiff and creditors." (Pl.'s Opp'n Mem. at 22, 23.) These are troubling allegations, indeed. The difficulty is that plaintiff fails to support them with anything more than its own attorney's affirmation, which is based mostly on secondhand information and belief. The court does not mean to suggest that plaintiff bears the ultimate burden of demonstrating prejudice to the satisfaction of the court. Indeed, if defendants fail to offer some compelling proof of their own on this subject, the determination should prove a fairly easy one. However, as with defendants' counterclaims, there simply is not enough information on the record for this court to make a reasoned determination on this issue. And given the enormous sums of money at stake in this case, along with the Second Circuit's avowed preference for settling disputes on the merits, the court believes it wise to refer this factual dispute to Magistrate Judge Maas as well.

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[16] To be perfectly clear, defendants' are ordered to confine their evidentiary submissions concerning the merits of their defenses to the seven remaining counterclaims specified above. The purpose of this hearing is not to give defendants an opportunity to comb the case law for still more legal defenses to interpose in this case—the time for that endeavor has passed.

CONCLUSION

To summarize, defendants have not, as yet, presented sufficient evidence on the issues of willfulness, meritorious defense, and prejudice to justify vacating the default judgment. What they have done is raise a number of questions that warrant further briefing and factual inquiry. Accordingly, the court refers them to Magistrate Judge Frank Maas for report and recommendation.

IT IS SO ORDERED.

Dated: New York, New York
February 4, 2002

s/ Robert L. Carter
ROBERT L. CARTER
U.S.D.J.

APPENDIX G — ORDER OF THE UNITED STATE COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING PETITION FOR REHEARING FILED SEPTEMBER 1, 2004

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
THURGOOD MARSHALL U.S. COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

Roseann B. MacKechnie
CLERK

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, Foley Square, in the City of New York, on the day of September two thousand four.

STATE STREET BANK AND TRUST COMPANY,

Plaintiff-Appellee,

v.

INVERSIONES ERRAZURIZ, LIMITADA (f/k/a Inversiones Errazuriz S.A.); SUPERMERCADOS UNIMARC S.A. (f/k/a Commercial E Inmobiliaria Unimarc S.A.), PESQUERA NACIONAL S.A., UNIMARC ABASTECIMIENTOS S.A., CIDEF S.A., SALMONES UNIMARC S.A., INDUSTRIA FORESTAL NACIONAL S.A., FORESTAL REGIONAL S.A., CIDEF ARGENTINA S.A., CORPORATION DE INVERSIONES Y DESARROLLO FINANCIERO

Appendix G

CIDEF S.A., and SOCIEDAD CONTRACTUAL MINERA COMPANIA DE SALITRE Y YODO PRIMERA REGION (f/k/a Compania De Salitre Y Yodo Primera Region S.A.),

Defendants-Appellants.

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the appellant Inversiones Errazuriz Limitada, et al.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

For the Court,
Roseann B. MacKechnie, Clerk

By: s/ [illegible]
Motion Staff Attorney

APPENDIX H — RELEVANT STATUTES

Rule 60. Relief From Judgment or Order

(b) Mistakes; Inadvertence; Excusable Neglect; Newly Discovered Evidence; Fraud, Etc.

On motion and upon such terms as are just, the court may relieve a party or a party's legal representative from a final judgment, order, or proceeding for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence which by due diligence could not have been discovered in time to move for a new trial under Rule 59(b); (3) fraud (whether heretofore denominated intrinsic or extrinsic), misrepresentation, or other misconduct of an adverse party; (4) the judgment is void; (5) the judgment has been satisfied, released, or discharged, or a prior judgment upon which it is based has been reversed or otherwise vacated, or it is no longer equitable that the judgment should have prospective application; or (6) any other reason justifying relief from the operation of the judgment. The motion shall be made within a reasonable time, and for reasons (1), (2), and (3) not more than one year after the judgment, order, or proceeding was entered or taken. A motion under this subdivision (b) does not affect the finality of a judgment or suspend its operation. This rule does not limit the power of a court to entertain an independent action to relieve a party from a judgment, order, or proceeding, or to grant relief to a defendant not actually personally notified as provided in Title 28, U.S.C., § 1655, or to set aside a judgment for fraud upon the court. Writs of coram nobis, coram vobis, audita querela, and bills of review and bills in the nature of a bill of review, are abolished, and the procedure for obtaining any relief from a judgment shall be by motion as prescribed in these rules or by an independent action.

Rule 54. Judgments; Costs

(c) Demand for Judgment. A judgment by default shall not be different in kind from or exceed in amount that prayed for in the demand for judgment. Except as to a party against whom a judgment is entered by default, every final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in the party's pleadings.

Rule 55. Default

(b) Judgment. Judgment by default may be entered as follows:

(2) By the Court. In all other cases the party entitled to a judgment by default shall apply to the court therefor; but no judgment by default shall be entered against an infant or incompetent person unless represented in the action by a general guardian, committee, conservator, or other such representative who has appeared therein. If the party against whom judgment by default is sought has appeared in the action, the party (or, if appearing by representative, the party's representative) shall be served with written notice of the application for judgment at least 3 days prior to the hearing on such application. If, in order to enable the court to enter judgment or to carry it into effect, it is necessary to take an account or to determine the amount of damages or to establish the truth of any averment by evidence or to make an investigation of any other matter, the court may conduct such hearings or order such references as it deems necessary and proper and shall accord a right of trial by jury to the parties when and as required by any statute of the United States.

APPENDIX I — LETTER FROM FRANCISCO JAVIER ERRÁZURIZ O., GENERAL MANAGER, INVERSIONES ERRÁZURIZ LIMITADA TO DAN LOBDELL, VICE PRESIDENT, INTERNATIONAL CORPORATE BANKING DATED JANUARY 8, 1999

INVERRAZ
INVERSIONES ERRAZURIZ LTDA.

January 8 1999

BY FACSIMILE AND
BY EXPRESS COURIER

State Street Bank and Trust Company
225 Franklin Street
Boston, MA 02110-2804
USA

Attn.: Dan Lobdell
Vice President, International Corporate Banking

Dear Mr. Lobdell:

Reference is made to the U.S.$65,000,000.- Credit Agreement dated as of March 1, 1996 (the "Credit Agreement") between Inversiones Errázuriz S.A., now Inversiones Errázuriz Limitada (the "Company") and State Street Bank and Trust Company. Terms defined in the Credit Agreement and not otherwise defined herein are used herein as defined in the Credit Agreement.

Pursuant to Paragraph 5L(b) of the Credit Agreement, notice is hereby given that a Liability Calculation Date occurred on January 1, 1999 due to the occurrence of a Fifteen Percent Transfer as a result of the sale by Compañia Salitre y Yodo 1ª Región S.A. of certain non-iodine related assets to Cosayach Nitratos S.A. another subsidiary of Inverraz. This sale comprised more than fifteen percent of the consolidated fixed assets of the seller. Considering this sale, and the increase or decrease in the Total Assets of the other Guarantors, the following Eligible Subsidiaries shall become or shall continue to be Guarantors as of such date. The amount of each Guarantor's Attributable Liability is stated opposite the name of such Guarantor.

Guarantor	**Attributable Liability (U.S.$)**
Supermercados Unimarc S.A.	30,221,864.-
Cidef Argentina S.A.	13,281,325.-
Pesquera Nacional S.A.	11,599,760.-
Cidef S.A.	9,897,052.-

Please note that Salmones Unimarc S.A, Fruticola Nacional S.A. and Ganadera y Forestal Nacional S.A., in addition to the already mentioned Compañia Salitre y Yodo 1ª Región S.A., have also ceased to be Guarantors, in accordance with the terms of the Credit Agreement.

Attached hereto as Attachment I is a certificate of the Chief Financial Officer of the Company certifying as to the accuracy of the calculations supporting such determination of the Guarantors and the Attributable Liability of each Guarantor.

Appendix I

Please give us written confirmation, in the form stated below, that this Notice of the Substitution of Guarantors and Reallocation of Attributable Liabilities has been properly received, agreed and accounted far. As a consequence, we also request State Street to give the previous Guarantors confirmation that their Attributable Liability under paragraph 2 of the Affiliate Guaranty have been reduced to the amounts specified in this Notice.

Should you require any additional information regarding the changes discussed herein, or if there is anything else in which we can be of assistance, please do not hesitate to call either myself or Mr. José Pablo Dulanto, General Counsel of the Company, at the below referenced number.

Very truly yours,

s/ Francisco Javier Errázuriz O.
General Manager
Inversiones Errázuriz Limitada

RECEIVED AND AGREED BY:

s/ Kelley L. Rumps
Kelley L. Rumps
State Street Bank and Trust Company